BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

STATEMENT OF JURISDICTION.

The jurisdiction of this Court is invoked under Section 313(b) of the Federal Power Act (49 Stat. 860, 16 U. S. C. A. Section 825 *l*) and Section 240 of the Judicial Code, as amended (43 Stat. 938, Section I, 28 U. S. C. A. Section 347). The statute, the validity of which is involved, is the Federal Power Act of 1935 (49 Stat. 847, 16 U. S. C. A. Section 791(a)). The judgment of the Circuit Court of Appeals was entered June 15, 1945 (R. 1250) and petition for rehearing was denied August 6, 1945 (R. 1251), and this petition is filed within three months thereafter.

STATEMENT OF FACTS.

A summary statement of the facts is set forth in the petition herein *ante* pp. 1 to 7.

SPECIFICATION OF ERRORS.

The Court below erred:

1. In denying to Petitioner the privilege of introducing evidence with respect to the nature of the services rendered by the Engineering Company and the reasonableness of the fees paid therefor.

2. In holding that the Commission might deny to Petitioner the privilege of introducing evidence with respect to the nature of the services rendered by the Engineering Company and the reasonableness of the fees paid therefor.

3. In affirming the order of the Commission requiring Petitioner to dispose of the amount of $828,684.97 reclassified in Account 100.5 by charging such amount to Petitioner's income inasmuch as the Commission has no authority

under the Act, or otherwise, to require that Petitioner dispose of any part of its property for the reason that the cost thereof is in excess of the "original cost" of such property.

4. In affirming the order of the Commission ordering the transfer of $636,237.23 from Account 100.1 to Account 107, and requiring Petitioner to dispose of such amount of $636,237.23 so reclassified by the Commission in Account 107 by charges to the capital surplus or earned surplus of Petitioner.

5. In affirming the order of the Commission requiring that Petitioner dispose of asset items existing in Petitioner's accounts for a period of over 30 years prior to the time that the Commission might assert any authority with respect to Petitioner's accounting.

6. In affirming the order of the Commission requiring that Petitioner employ its capital surplus or earned surplus for the purpose of "disposing of" the amount of $828,684.97 reclassified by Petitioner in Account 100.5 and the amount of $636,237.23 sought to be reclassified by the Commission in Account 107, which order violated the constitutional and property rights of Petitioner and its stockholders.

7. In affirming the order of the Commission requiring Petitioner to charge off the amount of $828,684.97 reclassified by Petitioner in Account 100.5 and the amount of $636,237.23 sought to be reclassified by the Commission in Account 107 for the reason that the Commission, in requiring such disposition, has not kept within the bounds of its authority under the Act, has contravened the Fifth and Tenth amendments of the Constitution, and Sections 1 and 2 of Article III of the Constitution, and has trespassed upon the regulatory authority reserved to the states by the Act and by the Tenth amendment to the Constitution.

8. In affirming the order of the Commission requiring the disposition of any part of the difference between the original cost of the electric property of Petitioner and the cost thereof as recorded on the books of Petitioner and in requiring the reclassification in Account 107 and the disposition of a part of the cost of such properties, for the reason that such requirements are arbitrary and capricious, violate the Fifth and Tenth amendments to the Constitution, constitute the taking of property without the payment of just compensation therefor, are contrary to the provisions of Sections 1 and 2 of Article III of the Constitution, and violate the constitutional guarantees of due process and the judicial determination of fundamental questions of fact and of law.

SUMMARY OF ARGUMENT.

Petitioner's argument may be briefly summarized as follows:

1. That Petitioner has not been afforded a full hearing with respect to the issues involved and for that reason has been denied due process of law, as explained on pages 16-21 of this brief.

2. That for the reasons set forth on pages 21-43 of this brief the Act does not vest the Commission with jurisdiction to require Petitioner to charge to its income or other accounts the amount of $828,684.97 reclassified by Petitioner in Account 100.5, Electric Plant Acquisition Adjustments, for the purposes of the Uniform System of Accounts prescribed by the Commission.

3. Petitioner's property is wrongfully taken and its constitutional rights are violated by the order of the Commission requiring that Petitioner dispose of the amount of $828,684.97 reclassified by Petitioner in Account 100.5,

and the amount of $636,237.23 sought to be established by the Commission in Account 107, by charges against the income or earned surplus or capital surplus of Petitioner, as shown by the argument at pages 43-70.

4. The Commission, as explained on pages 70-80, has no jurisdiction to regulate any of the matters subject to regulation by the states.

5. It does not lie within the province of the Commission to interfere with managerial functions, hence the order of the Commission requiring Petitioner to write off or charge off a part of its plant property is an arbitrary act not within any regulatory powers of the Commission. Pages 81-84.

ARGUMENT.

I.

PETITIONER HAS NOT BEEN AFFORDED A FULL HEARING WITH RESPECT TO THE ISSUES INVOLVED, AND HENCE HAS BEEN DENIED DUE PROCESS OF LAW.

Paragraphs (2) and (7) of the order of the Commission dated February 3, 1943 (R. 37), require that Petitioner remove from Account 100.1, Electric Plant in Service, the amount of $636,237.23 and reclassify such amount of $636,237.23 in Account 107, Electric Plant Adjustments, as representing "inter-company profits" and a "write-up of electric plant," and that such alleged "write-up" then be charged in its entirety to the capital surplus or earned surplus of Petitioner. The reasoning employed by the Commission in support of these provisions in its order is that such amount of $636,237.23 represents profits made by the Engineering Company on services rendered to Petitioner during the period from 1926 to 1935, during which time Petitioner and the Engineering Company were affiliates.

This arbitrary determination of a "write-up" in the plant accounts of Petitioner was first made in the Commission's staff report (Ex. 5, R. 908), without any findings as to whether or not the amounts paid by Petitioner to the Engineering Company for services rendered were reasonable, and with no evidence before the staff or the Commission as to the character of the services rendered.

Petitioner had planned to have available at the hearing held in San Francisco engineering witnesses who could testify with respect to the value of the services rendered by the Engineering Company to Petitioner, and the reasonableness of the amounts paid therefor. Ordinarily qualified engineering witnesses would have been available for

this purpose. In making inquiry with respect thereto Petitioner found, however, that all of the qualified experts in the San Francisco area, or within a reasonable distance thereof, who would ordinarily have been available to testify on Petitioner's behalf, were engaged either directly or indirectly in work related to the prosecution of the war, and for that reason would not be available to testify until some time after the close of the San Francisco hearing. Similarly, the officers and employees of the Engineering Company were at that time engaged in performing work for the various client companies of the Engineering Company necessitated to a large extent by the nation's defense and war program. The Court can take judicial notice of the fact that at the time of the hearing held in San Francisco in February and March, 1942, our country had been at war for a period of approximately 3 months, and that there existed a state of national emergency.

For these reasons, and because the Commission saw fit to test its accounting theories during a time of war, Petitioner was obliged to request that the Trial Examiner grant a continuance of the hearing (R. 300-305; 574-579; 1132) so as to permit Petitioner

(a) to introduce evidence with respect to the reasonableness of the fees paid by Petitioner to the Engineering Company for such services; and

(b) to introduce evidence with respect to the services rendered to Petitioner by the Engineering Company.

At the conclusion of the hearing Petitioner made a formal motion (R. 1175) that the hearing be continued so that it might have an opportunity to introduce such evidence, such adjourned hearing to be held either at the offices of the Commission in Washington, D. C. or at San Francisco or in Portland, Oregon, as might best suit the convenience of the Commission (R. 1177). This motion was de-

nied by the Trial Examiner (R. 1179) on the grounds that such evidence related to "matters that are *irrelevant* in this proceeding."

Following such action by the Trial Examiner Petitioner, in accordance with the provisions of Section 1.180 et seq. of the Rules of Practice and Regulations of the Commission, filed a petition with the Commission (R. 16) for a further hearing to enable Petitioner to adduce such additional evidence, which petition was denied by the Commission (R. 21) on the grounds that

> "(c) At said hearing Petitioner was given an opportunity to make a full presentation of its case;
>
> (d) The Petitioner had ample opportunity to adequately prepare for such hearing;
>
> (e) The reasons cited in the petition filed March 30, 1942, do not justify or constitute good cause for a further hearing in this matter."

In its petition for rehearing filed with the Commission (R. 39), Petitioner set forth as one of the reasons for the granting of a rehearing the fact that the Trial Examiner and the Commission had erred in refusing to give Petitioner a further hearing so that it might be afforded the opportunity of introducing evidence as aforesaid. Such petition for rehearing was denied by the Commission (R. 56).

Following the filing of its petition for review in this proceeding, Petitioner filed in the Court below its motion for leave to adduce additional evidence in accordance with the provisions of Section 313(b)[8] of the Act, 16 U. S. C. A. 825 *l*, which motion was denied.

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[8] Section 313(b) of the Act provides in part as follows:

"If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper."

The additional evidence so sought to be adduced by Petitioner is the same evidence with respect to which a continuance was asked at the hearing in San Francisco, i.e., evidence with respect to the reasonableness of the fees paid to Petitioner by the Engineering Company for services rendered, and with respect to the services so rendered to Petitioner by the Engineering Company.

The Act provides that the burden of proof to justify every accounting entry questioned by the Commission shall be on the person making, authorizing or requiring such entry, and that the Commission may suspend a charge or credit pending submission of satisfactory proof in support thereof. (Section 301(a), 16 U. S. C. A. 825(a)). In *Northwestern Electric Company, et al.* v. *Federal Power Commission,* 134 F. (2d) 740, the Court below held that the phrase "burden of proof" as employed in Section 301(a) of the Act means the burden of going forward with the evidence.

In the present case, however, the Commission was apparently of the opinion that this statutory provision with respect to the burden of proof was insufficient, inasmuch as the Commission indulged in the presumption of its staff in advance of any hearing or notice of hearing that some part of the profits of the Engineering Company, as determined by the Commission, were an improper element of plant costs.

Obviously the only way that Petitioner could meet and overcome this arbitrary presumption of the Commission with respect to the services performed by the Engineering Company was to introduce evidence by experts in respect to the reasonableness of the fees paid by Petitioner to Engineering Company, and evidence by the officers and employees of the Engineering Company as to the nature and value of the services rendered. Such additional evidence is material, and Petitioner was denied the opportunity to

introduce such additional material evidence by the Commission. It was denied such right by the Trial Examiner in the first instance (R. 1179) in such a manner as to indicate that the Commission would not have considered such evidence even if it had been introduced. The subsequent denial of this substantive right by the Commission, on petition for further hearing, was based upon the unwarranted and unsupported statement that Petitioner "was given an opportunity to make a *full* presentation of its case."

There is no intimation either in the staff report (Ex. 5, R. 908) or in the findings and opinion of the Commission (R. 23) that the amount paid by Petitioner for such services of the Engineering Company was not in accord with the going rate for engineering services during the period in question, or that the services were not rendered, or that there were any improper transactions between Petitioner and the Engineering Company with respect thereto. The only argument advanced by the Commission in arbitrarily seeking to compel Petitioner to charge off $636,237.23 is the fact that engineering services were rendered to Petitioner by an affiliate during the ten-year period in question; that the amount paid by Petitioner to the Engineering Company for such services was in excess of the cost thereof to the Engineering Company, as such cost was determined by the Commission, and that the "profit" of the Engineering Company so determined by the Commission constitutes a "write-up" of the plant accounts of Petitioner (R. 23-35).

For a period of almost four years Petitioner has sought unsuccessfully to introduce evidence in these proceedings with respect to the reasonableness of the fees paid by Petitioner to the Engineering Company and the nature and value of the engineering services rendered to Petitioner by Engineering Company, but for some reason unknown to Petitioner the Commission seems determined not to permit such evidence to become a part of the record.

Under Section 301(a) of the Act, the Commission may "after notice and *opportunity for hearing*" determine by order the accounts in which particular outlays and receipts shall be entered, etc. It is too well settled to require argument that such a hearing would embrace the right on Petitioner's part to have a reasonable opportunity to know the claims of the Commission and to meet them. The right to meet the claims of the Commission includes the right to present evidence, which right was denied by the Commission. This Court in the Morgan case, *Morgan* v. *United States*, 304 U. S. 1, 82 L. Ed. 1129, and cases there cited recognizes the requirement of a fair hearing before an administrative agency as an "inexorable safeguard, and that such agencies must accredit themselves by acting in accordance with the cherished judicial tradition embodying the basic concepts of fair play."

Unless Petitioner is permitted to complete the record in this proceeding by introducing evidence with respect to the value and nature of the services rendered by Engineering Company to Petitioner, Petitioner will have been denied an adequate hearing because of the arbitrary attitude of the Commission.

II.

THE ACT DOES NOT VEST THE COMMISSION WITH JURISDICTION TO REQUIRE PETITIONER TO CHARGE TO ITS INCOME OR OTHER ACCOUNTS THE AMOUNT OF $828,684.97 RECLASSIFIED BY PETITIONER IN ACCOUNT 100.5, ELECTRIC PLANT ACQUISITION ADJUSTMENTS, FOR THE PURPOSES OF THE UNIFORM SYSTEM OF ACCOUNTS PRESCRIBED BY THE COMMISSION.

Under Section 208(a) of the Act, as amended, 16 U. S. C. A. 824g, the Commission may

> "* * * investigate and ascertain the actual legitimate cost of the property of every public utility, * * *.

(b) Every public utility upon request shall file with the Commission an inventory of all or any part of its property and a statement of the original cost thereof, * * *."

Section 301(a) of the Act, 16 U. S. C. A. 825(a), authorizes the Commission to

"* * * prescribe a system of accounts to be kept by licensees and public utilities and may classify such licensees and public utilities and prescribe a system of accounts for each class. The Commission, after notice and opportunity for hearing, may determine by order the accounts in which particular outlays and receipts shall be entered, charged, or credited. The burden of proof to justify every accounting entry questioned by the Commission shall be on the person making, authorizing, or requiring such entry, and the Commission may suspend a charge or credit pending submission of satisfactory proof in support thereof."

There is no provision in the Act which either directly or inferentially provides that the Commission, in connection with its investigation and ascertainment of "actual legitimate cost" or "original cost" of the property of a public utility, or in the prescribing of a system of accounts for public utilities, or otherwise, may require such public utility to charge off any portion of its property accounts comprising a part of the cost of acquisition of property acquired by a public utility, for the reason that such acquisition cost exceeds the "original cost" of the property so acquired.

JURISDICTION OF THE COMMISSION TO DETERMINE THE "ORIGINAL COST" OF PROPERTY OF A UTILITY IS LIMITED TO THE ASCERTAINING OF "ACTUAL LEGITIMATE COST" UNDER THE ACT.

Section 208(a) of the Act, 16 U. S. C. A. 824g, above referred to provides only for the investigation and ascer-

taining of the "actual legitimate cost" of the properties of public utilities, and that the Commission may request that public utilities file an inventory of their properties and a statement of the "original cost" thereof. There is nothing in this section of the Act, or in any other section of the Act, requiring or authorizing the Commission, after it has exercised its power to investigate and ascertain actual legitimate cost, to compel a public utility subject to its jurisdiction to write off or charge off any part of its property. In the carrying out of the provisions of Section 208 of the Act, or any other sections thereof, there is no necessity for the charging off of any part of the property of a public utility, and the Commission is not authorized to require any such charge off.

The Commission has heretofore ascertained what it regards as the actual legitimate cost, or original cost, of the electric properties of Petitioner, and its findings in that regard, and the records and data upon which they are based, are a part of the files of the Commission. The original cost of Petitioner's electric property cannot be changed by any action that Petitioner might take in so far as the treatment of its accounting records is concerned, and Petitioner is not objecting, in this proceeding, to recording on its books the original cost of its electric properties, or to the segregation in its accounts of any excess of actual cost over original cost. The attempt on the part of the Commission to require Petitioner to charge off the amounts found by the Commission as being in excess of the original cost of such properties is therefore unnecessary to the exercise of any powers of the Commission, and is unreasonable, arbitrary and invalid. The powers of the Commission can only be found in the Act, and where jurisdiction has not been conferred by the Act the Commission cannot proceed. *Connecticut Light & Power*

Company v. *Federal Power Commission*, ... U. S. ...; 89 L. Ed. Adv. Op. 691.

The Commission, once having ascertained the original cost of the electric property of Petitioner, pursuant to the provisions of Section 208(a) of the Act, has exercised and exhausted its powers under that section.

THE COMMISSION IS ATTEMPTING TO LIFT ITSELF BY ITS OWN BOOTSTRAPS WHEN IT ASSUMES THAT UNDER ITS LIMITED AUTHORITY TO CLASSIFY ACCOUNTS IT MAY COMPEL PETITIONER TO CHARGE OFF A PART OF ITS PROPERTY.

As the Commission says in its opinion (R. 36) "there is no dispute as to the origin or classification" of the amount of $828,684.97 included in Account 100.5. It represents the excess of acquisition cost over original cost of operating units or systems purchased. The issue is whether the Commission may require that Petitioner should deduct such amount from its earnings over a period of ten years, or whether it is to be permitted to remain in Account 100.5. Petitioner contends it should be permitted to remain in Account 100.5.

An administrative body authorized to promote uniformity of accounting methods through the promulgation of a uniform system of accounts cannot, under the guise of such authority, seek to compel a public utility to write off a part of its property contrary to the judgment of those entrusted with the management of such property. There have been other instances, however, where regulatory commissions have sought to accomplish, either directly by a specific order, or indirectly through orders relating to accounting procedure, the charging off of property in the manner in which the Commission is now seeking to compel

Petitioner to charge off a part of its property. In each instance the Courts have held these attempts to have been improper. Where an accounting order affects property rights it is not a matter of form, but of substance. *Norfolk & Western Railway Co.* v. *United States et al.*, 52 Fed. (2d) 967, 970; *New York Telephone Company* v. *United States, et al.*, 56 Fed. Supp. 932. And an administrative order "cannot be upheld unless the grounds upon which the agency acted in exercising its powers were those upon which its action can be sustained." *Securities and Exchange Commission* v. *Chenery Corporation, et al.*, 318 U. S. 80, 95; 87 L. Ed. 626, 637.[9]

The Commission was only given authority under the Act to classify accounts for purposes of the Act. It cannot raise itself by its own bootstraps and take on the power to require substantive charges reducing earnings and dividends except pursuant to the substantive provisions of the Act. The only substantive provision relating to Petitioner is the regulation of interstate rates for electric energy under Section 205 of the Act (16 U. S. C. A. 824d). The charging off of the amount of $828,684.97 expended by Petitioner in the acquisition of its properties is certainly not required in the regulation of interstate rates. For the Commission to require deductions or charge-offs of the earnings and surplus of Petitioner, over which the Commission has no jurisdiction, substantially exceeds its authority.

This limitation on the jurisdiction of the Commission has recently been discussed at length by this Court in *Connecticut Light & Power Company* v. *Federal Power Commission, supra*, ... U. S. ...; 89 L. Ed. Adv. Op. 691,

[9] And see also *Commissioner of Internal Revenue* v. *Heininger*, 320 U. S. 467; 88 L. Ed. 171, and *Eastern-Central Motor Carriers' Association, et al* v. *United States*, 321 U. S. 194; 88 L. Ed. 668.

where the legislative history of the Act is reviewed, and where this Court held that the jurisdiction of the Commission did not extend to local distribution facilities and that there was no specific provision in the Act for federal jurisdiction over accounting except as to "public utilities." The legislative history of the Act, as so reviewed, does not reveal any language, and we have been unable to find any language in any of the proceedings relating to the adoption of the Act, indicating that the representatives of the Commission, who sponsored the Act, were of the opinion that the amendments advocated or supported by them would authorize the Commission, in procuring accounting information, to require a public utility or a licensee to charge off a part of its plant property, or that they were of the opinion that the Federal Water Power Act should be so amended.

From the foregoing it will be seen that Section 301 of the Act was passed only to give the Commission authority to compile a uniform body of information about the electric industry—not to regulate earnings or dividends or to require charges against earned surplus or capital surplus by "accounting" orders. The Commission has clearly exceeded the powers given it by Congress.

THE COURTS HAVE CONSISTENTLY HELD THAT CHARGE OFF REQUIREMENTS OF THE TYPE SOUGHT TO BE IMPOSED BY THE COMMISSION ARE BEYOND THE POWERS OF REGULATORY COMMISSIONS.

That the proposed charge-off of $828,684.97 in Account 100.5 is beyond the powers of the Commission has been directly held in the case of *New York Edison Co. et al.* v. *Maltbie et al.*, 244 App. Div. 685, relating to the New York Public Service Commission.

In 1934 the Public Service Commission of the State of New York revised the uniform system of accounts then in effect with respect to the public utilities subject to its jurisdiction. Such revised uniform system of accounts, among other things, required that the difference between the "original cost" of operating property acquired, and the cost of such property to the acquiring company, should be entered in a suspense account and should be written off over such period and in such manner as the New York commission might require. Such suspense account was similar in effect to Account 100.5, Electric Plant Acquisition Adjustments, of the Uniform System of Accounts prescribed by the Commission (Ex. 1). In holding that such uniform system of accounts constituted an arbitrary exercise of the powers of the New York Commission, and deprived the complaining utilities of their constitutional rights, the New York Supreme Court, Appellate Division, Third Department, in *New York Edison Company, et al.* v. *Maltbie, et al.*, 244 App. Div. 685; 281 N. Y. Supp. 223; 9 P. U. R. (N. S.), 155, used the following language (281 N. Y. Supp. 226):

> "If these orders were fairly and reasonably within the grant of power constitutionally conferred by the legislature, they are not open to judicial review. *Kansas City So. R. Co.* v. *United States*, 231 U. S. 423, 456, 34 S. Ct. 125, 58 L. ed. 296, 52 L. R. A. (N. S.) 1; *Interstate Commerce Commission* v. *Goodrich Transit Co.*, 224 U. S. 194, 216, 32 S. Ct. 436, 56 L. Ed. 729. If the Commission has assumed prerogatives not granted it or has abused the power granted by the legislature and has made orders that are arbitrary or which deprive the petitioners of constitutional rights, the court has the power of review. *Norfolk & W. R. Co.* v. *United States*, 287 U. S. 134, 142, 53 S. Ct. 52, 77 L. ed. 218. *The legislature granted to the Commission power to prescribe uniform methods of keeping*

accounts, records, and books (Subd. 4 § 66, P. S. L.). *The statute does not authorize the Commission to prescribe uniform methods of management of the business of privately owned corporations. The uniformity that may be enforced is not as to what shall be done or how it shall be done, but as to book entries in respect to whatever is done. Kansas City So. R. Co.* v. *United States, supra,* 231 U. S. 423, page 450, 34 S. Ct. 125, 58 L. ed. 296, 52 L. R. A. (N. S.) 1.

• • • *'The power vested in the Commission to prescribe uniform methods of keeping accounts and records* (Public Service Law, 66, Subd. 4) *does not include the power to compel a corporation to write off from its book value a loss which it has not sustained, or to give up a part of its constitutional rights. If as has been said ' "the actual cost of the property—the investment the owners have made—is a relevant fact" "* (*Los Angeles Gas & E. Corp.* v. *California R. Commission,* 289 U. S. 287, 306, 53 S. Ct. 637, 77 L. Ed. 1180, 53 S. Ct. 637) *a corporation cannot be compelled to make entries upon its books calculated to conceal such relevant fact. It follows that the Commission had no power to impose such condition.' People ex rel. Iroquois Gas Corp.* v. *Public Service Commission,* 264 N. Y. 17, 21, 189 N. E. 764, 766. The foregoing was written concerning a condition which the Commission sought to impose as to the purchase of the property of one utility corporation by another. If it lacks power as to one transaction, it also lacks power to enforce by a general rule such a condition as to all similar transactions." (Emphasis supplied.)

With respect to the original cost of assets acquired through intercompany transactions, the Court said (page 228):

"• • • *It* (the New York Commission) *could require that these facts be recorded in an account or memorandum disconnected from the fixed capital account, and thus avoid the unconstitutional requirement that*

losses which had not been suffered be shown on the books. The petitioners argue, and with high judicial authority, that the books of a utility corporation are not kept solely for the information or benefit of the Commission. That stockholders, bond owners, the investing public and ratepayers are interested; also that corporate financing is done upon the basis of book values. Norfolk & W. R. Co. v. *United States,* (1931) 52 F. (2d) 967. That to be required to show a loss on the books when none has been suffered is arbitrary. Many of the fixed capital accounts ordered to be redistributed contain entries reflecting purchases from predecessor utilities that were approved by the Commission and other entries concerning consolidation and purchases which have been approved by courts, including the Supreme Court of the United States. These entries are not made upon the basis of 'original cost' as the Commission now seeks to define it. Financing has been carried on and transactions made on the basis of these figures as to fixed capital. *A requirement that a part now be charged off is confiscatory.*" (Emphasis supplied.)

The Maltbie case is later reported in 271 N. Y. 103; 2 N. E. (2d) 277, where the Court of Appeals of New York affirmed the Appellate Division in its construction of the orders of the Public Service Commission. In such appeal the following question was certified to the Court of Appeals:

"'4. If questions numbered "1," "2," and "3" be answered in the affirmative, are the provisions of the said orders of the Commission which direct corporations to write-off and eliminate from their books of account and records by charges against income or surplus such amounts as may be determined to be the excess of "book cost," as therein defined, over "original cost," as therein defined, of their properties valid under the laws and Constitutions of the State of New York and the United States of America?'"

and was answered by the Court of Appeals *in the negative.*

The Court of Appeals of the State of New York also had occasion to pass upon the powers of the Public Service Commission of the State of New York to require a public utility to make a charge against its surplus. *People ex rel. Iroquois Gas Corporation* v. *Public Service Commission of the State of New York,* 264 N. Y. 17; 189 N. E. 764. The New York Commission in granting its consent to the sale of certain natural gas properties pursuant to the provisions of the Public Service Law of the State of New York, had required by order that Iroquois Gas Corporation *charge to its surplus a portion of the purchase price proposed to be paid for such property.* In holding that the Commission was without power to compel the writing off of a loss that it had *not* sustained the Court said (189 N. E. 766):

> "• • • The cost remains the same, but the Commission requires the purchaser to write off part of that price on its books so that the book value would be less than the price paid. If the purchase price is an element of value upon which the relator is entitled under the Constitution to a reasonable return, it is difficult to understand how an enforced entry upon the books would work any change. *The power vested in the Commission to prescribe uniform methods of keeping accounts and records does not include the power to compel a corporation to write off from its book value a loss which it has not sustained, or to give up a part of its constitutional rights.* If, as has been said, 'the actual cost of the property—the investment the owners have made—is a relevant fact' (*Los Angeles Gas & Electric Corp.* v. *Railroad Comm. of California,* 289 U. S. 287, 306, 53 S. Ct. 637, 644, 77 L. Ed. 1180), a corporation cannot be compelled to make entries upon its books calculated to conceal such relevant fact. It follows that the Commission had no

power to impose such condition.* * *" (Emphasis supplied.)

In *Passaic Consolidated Water Company* v. *Board of Public Utility Commissioners*, 5 N. J. Misc. 1078; 139 Atl. 324 (1927), (Affi'd 141 Atl. 921) the New Jersey Board of Public Utility Commissioners had ordered Passaic Consolidated Water Company to rewrite its books of account so as to show as the value of its property the values determined by such commissioners for rate-making purposes, and which values were substantially less than those recorded on the books of the water company. The Supreme Court of New Jersey, in setting aside such order, and in holding that the power of the Board of Public Utility Commissioners to supervise the accounting of public utilities did not include the power to fix the value at which property should be carried on the books of a utility, said (139 Atl. 325):

"*In disposing of this question, we will start out with the premise that the power of the board is that of regulation and not of asphyxiation. The right to regulate a utility does not destroy the right of private ownership. All the incidents of ownership, except in so far as it may be necessary to curtail them to properly exercise the power of regulation, remain with the corporation. If the order of the board is arbitrary and unreasonable and beyond the powers given to it by the statute, it is void.* It seems to us that one of the rights of private ownership is the keeping of accounts, not solely for the purpose of establishing a basis for fixing rates, but for such other matters as appertain to the ordinary business of a utility corporation. It owes to its stockholders certain rights that may require an entry upon its books of what it determines to be the fair value of its property. It must be recognized that when a board is fixing a basis for rates it may perchance mistakenly undervalue the property of the util-

ity or eliminate from the valuation elements which in the past have required the expenditure of considerable funds.

In ascertaining the income and excess profits upon which taxes have to be paid to the federal government, for example, it is fair that the full value of the property should be used. To use it requires that such a valuation shall be entered on the books of account. In the event of the sale of any of the company's property for which it has no longer use, there should be a record of the true value of such property. These illustrations might be multiplied. *They are only used for the purpose of showing that in the conduct of the affairs of a corporation questions regarding its property will arise which require that there be entered upon its books other entries than that of the valuation fixed by the utility board for rate-making purposes.*

It is well settled that, when bodies are created for the regulation of utility companies, the presumption is that the power of regulation conferred does not extend beyond the express terms of the grant. *State* v. *Patterson*, 229 Mo. 373, 129 S. W. 892." (Emphasis supplied.)

In passing upon the powers of the Interstate Commerce Commission to prescribe rules of accounting for the carriers subject to its jurisdiction a statutory three-judge court said (*Norfolk & Western Railway Co.* v. *United States et al.*, 52 Fed. (2d) 967, 970):

"But while we do not think that an accounting order such as this can be treated either as a binding classification of property in a rate-making or recapture proceeding or as a step in such proceedings, we cannot say that it imposes no burden or hardship furnishing ground for injunctive relief, if in fact it transcends the power of the commission or is so manifestly arbitrary and unreasonable as to evidence an abuse of discretion. *Accounting under the order of the commis-*

sion is not a mere matter of form, but one of substance. It sets forth the condition of public carriers for the information of their stock and bondholders and the investing public as well as for that of the commission. It furnishes the basis of corporate financing, and many other matters affecting their very existence. They are entitled, therefore, not to be subjected to accounting orders which transcend the powers of the commission or which are arbitrary or unreasonable; and we have no doubt that, as against an accounting order which so offends, a carrier is entitled to relief by injunction. There is jurisdiction in equity, therefore, to entertain the suit which has been instituted. See *Kansas City Sou. R. Co.* v. *U. S.*, 231 U. S. 423, 34 S. Ct. 125, 58 L. Ed. 296, 52 L. R. A. (N. S.) 1; *Atlanta, B. & C. R. Co.* v. *U. S.* (D. C.) 28 F. (2d) 885." (Emphasis supplied.)[10]

THE AMERICAN TELEPHONE AND TELEGRAPH COMPANY CASE.

In the American Telephone and Telegraph Company case 299 U. S. 232; 81 L. Ed. 142, this Court refused to disapprove the system of accounts adopted by the Federal Communications Commission—and similar in purport to the Uniform System of Accounts of the Commission—only after the Federal Communications Commission had agreed that charge-offs would be made only of "fictitious or paper increments."

The Federal Communications Commission, by its Order 7-C issued June 19, 1935 and effective January 1, 1936, established a uniform system of accounts for telephone companies subject to its jurisdiction pursuant to the authority granted by Section 220 of the Federal Communications Act, (47 U. S. C. A. 220). Such uniform system of accounts required that the telephone companies show on

[10]The same case is also reported in 287 U. S. 134; 77 L. Ed. 218.

their accounting records the original cost of their properties, the term "original cost" being defined as

> "the actual money cost of or the current money value of any consideration other than money exchanged for property at the time when it was first dedicated to the public use, whether by the accounting company or by a predecessor public utility."

Among the accounts required to be kept by the telephone companies was Account 100.4, Telephone Plant Acquisition Adjustment, such account to include the amount by which the price paid for operating property acquired as a unit should exceed the "original cost" of such property as above defined. The instructions with respect to Account 100.4, Telephone Plant Acquisition Adjustment, required that (page 238)

> "the amounts recorded in this account with respect to such property acquisition shall be disposed of, written off, or provision shall be made for the amortization thereof in such manner as this Commission may direct."

A bill was filed by American Telephone and Telegraph Company and a large number of other telephone companies to enjoin the enforcement of such uniform system of accounts by the Federal Communications Commission (14 Fed. Supp. 121).

In passing upon the propriety of certain of the accounting requirements of such uniform system of accounts, and particularly the foregoing provisions thereof relating to the disposition of the amount by which the cost of telephone property exceeded the "original cost" thereof, Mr. Justice Cardozo employed the following language (page 237):

> "• • • Then too, in gauging rationality, regard must steadily be had to the ends that a uniform system of accounts is intended to promote. '*The object*

of requiring such accounts to be kept in a uniform way and to be open to the inspection of the Commission is not to enable it to regulate the affairs of the corporation not within its jurisdiction, but to be informed concerning the business methods of the corporations subject to the act that it may properly regulate such matters as are really within its jurisdiction.' Interstate Commerce Commission v. *Goodrich Transit Co.,* 224 U. S. 194, 211, 56 L. Ed. 729, 736, 32 S. Ct. 436; cf. *Kansas City S. R. Co.* v. *United States, supra* (231 U. S. 445, 58 L. Ed. 305, 34 S. Ct. 125, 52 L. R. A. (N. S.) 1). * * *'' (Emphasis supplied).

This Court then discussed the charge off provisions of the accounting system (page 240):

> ''The companies object that by the 'original cost' provisions of the order they are prevented 'from recording their actual investment in their accounts' with the result that the accounts do not fairly exhibit their financial situation to shareholders, investors, tax collectors and others.''

For the purpose of obtaining an advance interpretation of the requirements of Account 100.4, Telephone Plant Acquisition Adjustments Account, particularly with respect to the possible requirements of the Federal Communications Commission in requiring telephone companies to charge off or write off the difference between the ''original cost'' of the properties acquired by them from other telephone companies and the value at which such properties were carried on the books of the acquiring company, this Court requested the Assistant Attorney-General appearing for the Government to submit a statement in behalf of the Federal Communications Commission with respect thereto. In passing upon this aspect of the case Mr. Justice Cardozo uses the following language (page 240):

"If subdivision (C) (the charge-off requirements) had the meaning thus imputed to it, there would be force in the contention that the effect of the order is to distort in an arbitrary fashion the value of the assets. But the imputed meaning is not the true one. The Commission is not under a duty to write off the whole or any part of the balance in 100.4, if the difference between original and present cost is a true increment of value. *On the contrary, only such amount will be written off as appears, upon an application for appropriate directions, to be a fictitious or paper increment.* This is made clear, if it might otherwise be doubtful, by administrative construction. Thus, the Commission's chief-accountant testified that by the proper interpretation of account 100.4, amounts therein 'would be disposed of, after the character of the item had been determined, in a manner consistent with the general rules underlying the uniform system of accounts for the distribution of expenditures, according to their character, to operating expenses, income, surplus, *or remain an investment.*' Other witnesses gave testimony in substance to the same effect. But even more decisive are statements made by counsel, appearing for the Government and arguing the case before us. To avoid the chance of misunderstanding and to give adequate assurance to the companies as to the practice to be followed, we requested the Assistant Attorney-General to reduce his statements in that regard to writing in behalf of the Commission. He did this and informs us that 'the Federal Communications Commission construes the provisions of Telephone Division Order No. 7-C, issued June 19, 1935, pertaining to account 100.4' as meaning 'that amounts included in account 100.4 that are deemed, after a fair consideration of all the circumstances, to represent an investment which the accounting company has made in assets of continuing value will be retained in that account until such assets cease to exist or are retired; and, in accordance with paragraph (C) of account 100.4, provision will be made for their amortization.'

> *"We accept this declaration as an administrative construction binding upon the Commission in its future dealings with the companies. Hicklin* v. *Coney,* 290 U. S. 169, 175, 78 L. Ed. 247, 251, 54 S. Ct. 142; *Matthew Addy Co.* v. *United States,* 264 U. S. 239, 245, 68 L. Ed. 658, 661, 44 S. Ct. 300. The case in that respect is sharply distinguished from *New York Edison Co.* v. *Maltbie,* 244 App. Div. 685, 281 N. Y. S. 223; 271 N. Y. 103, 2 N. E. (2d) 277, where under rules prescribed by the Public Service Commission of New York, *there was an inflexible requirement that an account similar in some aspects to 100.4 be written off in its entirety out of surplus, whether the value there recorded was genuine or false.* The administrative construction now affixed to the contested order devitalizes the objection that the difference between present value and original cost is withdrawn from recognition as a legitimate investment." (Emphasis supplied.)[11]

The amount of $828,684.97 involved in this proceeding is admittedly neither "fictitious" nor a "paper increment" but is the aggregate of amounts representing arm's-length payments by Petitioner, and the Commission does not question the fact that this amount is a proper item of cost to Petitioner. The Commission's reference to the items as "intangibles" does not make them "fictitious." All that this reference means is that Petitioner paid more for the property—at arm's-length and in good faith—than did the original investor. If the items had been "fictitious" or a "paper increment" the Commission would probably have sought to put them in Account 107 as a "write-up" and not in Account 100.5.

Petitioner made clear at the time that it filed its original cost study (Ex. 4) with the Commission that with respect to the electric properties acquired by it over a period of approximately thirty-three years prior to 1935, the cost

[11]See also same case as reported in 14 Fed. Supp. 121.

thereof to Petitioner had been $828,684.97 in excess of their "original cost" (Ex. 4, page 5), and that such amount of $828,684.97 was a part of the investment made by Petitioner in the development of its electric system, having been made to bring to that system, the investors therein, and to customers in the areas served, the benefits of integrated and interconnected electric utility service and the more efficient utilization of properties constructed and acquired, and that such benefits were applicable equally to the customers of the properties built and those acquired (Ex. 4, page 80).

The fact that the Commission regards its Uniform System of Accounts as giving the Commission authority to order the charging off of arm's-length investment is immaterial, because the Commission cannot raise itself by its bootstraps in this way. We do not have to consider whether or not Congress could have given this authority to the Commission because it is clear it did not do so.

The New York Telephone Company Case.

In the American Telephone and Telegraph Company case, supra, the American Company expressed the fear that the Federal Communications Commission, under a system of accounts almost identical with that of the Commission, would not be content with a reclassification of the accounts of the companies subject to its jurisdiction, but would attempt to compel the charging off of any difference between "original cost" as determined by that commission and the cost to the telephone companies of their respective properties. For that reason the recent case of *New York Telephone Company* v. *United States et al., supra*,[12] is most significant.

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[12] 56 Fed. Supp. 932. Now pending in this Court upon appeal. 89 L. Ed. Adv. Op. No. 14 (Cum. Tab.).

In that case New York Telephone Company brought an action against the United States of America and the Federal Communications Commission to enjoin an order of that commission. Such order directed the telephone company to charge off against its surplus the amount of $4,166,510.57 as representing the excess of payments made by the telephone company to its parent company, American Telephone and Telegraph Company, for telephone plant over the amount found by the Federal Communications Commission to represent the cost of such properties to the American Company. New York Telephone Company, at the time of the acquisition of such telephone plant, had complied with applicable regulatory accounting requirements, and as required later by the accounting system of the Federal Communications Commission, had shown the cost of such property in Account 100.4 (an account similar in effect to Account 100.5 Electric Plant Acquisition Adjustments, of the Commission).

The defendants moved for summary judgment on the ground that there was no genuine issue of fact, which motion was denied.

The Court, after discussing the American Telephone and Telegraph Company case, supra, said:

> "While appellants in that case complained that the system of accounting might authorize the Commission in the future to do something toward obliterating or striking out the difference between original cost and purchase price, the Court refused to adjudicate as to the validity of the system based upon any such anticipated action. It left the determination of that point to be decided upon whatever facts might subsequently be revealed as justifying it. It would seem that the only question here is whether the Commission now has power to direct the debit to surplus and the other charges to which complaint is now made. • • •

When the 'original cost' theory was introduced by the Communications Act of 1934, insofar as telephone companies were concerned, a new system of accounting was devised by the Federal Communications Commission which required for the first time the segregation of the so-called 'profit' into an account other than that in which original cost was entered. At that time some portion of the toll plant and instruments had been retired. The right to make the segregation was attacked in the American T. & T. Co. case, one of the reasons given being that because segregation was required, the difference between original cost and the alleged purchase price 'must be written off completely. The Commission is charged * * * with a mandatory duty to extinguish the entire balance recorded in' account 100.4 pursuant to subdivision (C) of that accounting requirement. Mr. Justice Cardozo answered that as above quoted.

(2) The administrative construction referred to, and plainly appearing in the stipulation then filed by the Counsel for the Federal Communications Commission, is not present in any of the other cases to which our attention has been called; and this case, for that reason, if for no other, is clearly to be distinguished from those cited. That administrative construction, if none other, it seems to us, precludes the action now taken until (1) there has been a 'fair consideration of all the circumstances', and (2) unless the difference between the original and present cost is not 'a true increment of value' but is a fictitious or paper increment'; and action to obliterate must depend upon 'evidentiary circumstances' later to be developed.

Here there has been no determination whether the difference between original cost and the price claimed to have been paid is a true increment of value, unless it is the arbitrary determination that it cannot be because it is the result of a transaction between a parent and an affiliate. There might be real doubt to make such a determination if based upon any such theory. *New York Edison Co.* v. *Maltbie*, 244 App.

Div. 685-689, 281 N. Y. S. 223, affirmed 271 N. Y. 103, 2 N. E. 2d 277.

(3) The order under review proceeds upon the theory that plaintiff's accounting in question was improper when made and should be corrected. In our opinion the entries made at the time of the four transactions in question accorded with the system prescribed by the Interstate Commerce Commission. They were recorded at 'actual money costs' and we do not understand that the fairness of the appraisals then made is questioned. Defendants' position is that the fairness of the appraisals is immaterial because in transactions between affiliates the transferee is bound to take the transferor's net book cost. *But if the entries were correct when made, as we now determine, the defendant Commission, under the present record, cannot apply retroactively a new system to write down the plaintiff's surplus. Arizona Grocery Co.* v. *Atchison, T. & S. F. R. Co.*, 284 U. S. 370-389 52 S. Ct. 183, 76 L. Ed. 348." (Emphasis supplied.)[13]

The New York Telephone Company case, therefore, is additional authority for the position of Petitioner that the Commission has no power to compel any retroactive accounting by Petitioner which would require the charging off of a part of its investment in its properties, and by which charge-off Petitioner would pay twice for a part of its property, i.e., one payment at the time of purchase, and a second payment through charges to its income or surplus.

REGULATION OF UTILITY ACCOUNTING AND PRESCRIBING OF UNIFORM SYSTEMS OF ACCOUNTS BY FEDERAL REGULATORY COMMISSIONS.

The requirement of uniformity in the accounting procedure of those public utilities or carriers subject to federal regulation is not a matter of recent origin. Interstate rail-

[13]Cf. *Claridge Apartments Company* v. *Commissioner of Internal Revenue*, 323 U. S. 141, 164; 89 L. Ed. Adv. Op. 137, 149.

roads have for years been subject to the accounting requirements of the Interstate Commerce Commission, which commission has been authorized to establish uniform accounting procedure for the carriers subject to its jurisdiction since the adoption of the Interstate Commerce Commission Act in 1887. The Interstate Commerce Commission was formerly authorized to establish uniform accounting procedure for interstate telephone companies, but in 1934, with the passage of the Federal Communications Act, such telephone accounting jurisdiction was transferred to the Federal Communications Commission, 47 U. S. C. A. 220. By the passage of the Federal Natural Gas Act in 1938, 52 Stat. 833; 15 U. S. C. A. 717 et seq., jurisdiction was conferred upon the Commission with respect to certain natural gas companies. Section 8 of that Act, 15 U. S. C. A. 717g, empowers the Commission to prescribe a system of accounts to be kept by such natural gas companies.

Ascertaining of "Original Cost" by Federal Regulatory Commissions.

In the case of the interstate railroads the Interstate Commerce Commission is also authorized to ascertain the original cost of the carriers subject to its jurisdiction, 49 U. S. C. A. 19a; the Federal Communications Commission is authorized to ascertain the original cost of the interstate telephone companies subject to its jurisdiction, 47 U. S. C. A. 213; and the Commission has been authorized, first, to ascertain the original cost of the electric utilities subject to its jurisdiction by Section 208 of the Act, 16 U. S. C. A. 824g, and later, upon the passage of the Federal Natural Gas Act, was authorized by Section 6 of that act, 15 U. S. C. A. 717e, to ascertain the original cost of the properties of those interstate natural gas companies subject to its jurisdiction.

It is highly significant, however, that these four federal acts, having for their common purpose the regulation of interstate carriers and public utilities and with a history extending from the adoption of the Interstate Commerce Commission Act in 1887 (Act of February 4, 1887, Chap. 104, Sec. 20; 24 Stat. at L. 386) to the adoption of the Natural Gas Act in 1938 contain no requirement, either with respect to the provisions thereof relating to the keeping of accounts, and authorizing the prescribing of uniform systems of accounts, or in those provisions relating to the ascertaining of the original cost of the properties of such carriers or public utilities, that provides that upon the ascertaining of such original cost the carrier or public utility would be required either to charge off from its property accounts the amount by which such original cost might be less than the book value of such property, or would be required to record upon its books the amount by which such original cost might exceed the book value of such property, as the case might be.

III.

THE COMMISSION, IN REQUIRING THAT PETITIONER CHARGE OFF TO ITS INCOME OR SURPLUS ACCOUNTS THE AMOUNT OF $828,584.97 RECLASSIFIED BY PETITIONER IN ACCOUNT 100.5, AND THE AMOUNT OF $636,237.23 WHICH THE COMMISSION SEEKS TO ESTABLISH IN ACCOUNT 107, AS A PART OF A DETERMINATION OF "ORIGINAL COST", IS ATTEMPTING A CONFISCATION OF THE PROPERTY OF PETITIONER IN VIOLATION OF ITS CONSTITUTIONAL RIGHTS.

The courts have consistently held that the requirement of a regulatory commission that a utility charge off a part of its property amounts to a confiscation and a taking of property without due process of law. 16 C. J. S. Constitutional Law, Section 699; *New York Edison Com-*

pany et al. v. *Maltbie et al., supra,* 244 App. Div. 685; 281 N. Y. Supp. 223, 9 P. U. R. (N. S.) 155; *New York Edison Company et al.* v. *Maltbie et al., supra,* 271 N. Y. 103; 2 N. E. (2d) 277; *People ex rel Iroquois Gas Corporation* v. *Public Service Commission of the State of New York, supra,* 264 N. Y. 17; 189 N. E. 764.

The language employed in these three opinions with respect to certain orders of the Public Service Commission of the State of New York effecting a confiscation of the property of the complaining utilities is set forth on pages 26-30 of this brief and therefore is not repeated here.

This Court has also consistently held that attempts on the part of regulatory bodies to fix unreasonable utility rates amount to a confiscation and a taking of property without due process of law and are therefore violative of the due process provisions of the federal constitution. Minnesota Rate Cases, 230 U. S. 352, 433; 57 L. Ed. 1511, 1555; *Los Angeles Gas and Electric Corporation* v. *California Railroad Commission,* 289 U. S. 287, 305; 77 L. Ed. 1180, 1192; *Pacific Gas & Elec. Co.* v. *Railroad Commission of the State of California* (1937), 301 U. S. 669; 81 L. Ed. 1933; affirming 13 F. Supp. 931, 16 F. Supp. 884; *West Ohio Gas Co.* v. *Public Utilities Commission of Ohio* (1935), 294 U. S. 78; 79 L. Ed. 773; *Chicago, M. & St. P. Ry. Co.* v. *Public Utilities Commission of Idaho* (1927), 294 U. S. 344; 71 L. Ed. 1085.

These cases, as well as substantially all of the other cases dealing with the confiscation of property of public utilities and carriers, grow out of orders or ordinances of the regulatory commissions or municipalities having the power to establish rates. In such cases the confiscation of the property of the utility has been brought about through the efforts of the regulatory commission or municipality, as the case may be, to establish rates that were not sufficient

to yield a fair return upon the value of the property of the utility, or the employment for rate making purposes of a property valuation so low as to make the return thereon confiscatory—not through an arbitrary requirement that a portion of the assets of the public utility be written off and thereby removed from the property accounts and balance sheet of the utility.

Only a few of the confiscation cases, among them the New York cases above cited, are concerned with a review of an arbitrary requirement for the charging off of a part of the property of a utility as a matter of accounting theory. The lack of case authority on this point results, no doubt, from the fact that the regulatory authorities have not sought to overstep the salutary constitutional limitation upon their powers, together with the fact that no known concept of public utility regulation requires that public utilities be subjected to the hazard of piecemeal confiscation of their properties through the orders of administrative bodies relating to accounting procedure.

It is seldom that the property component of a rate base employed in establishing rates for a public utility is the same in amount as the book value of such property. Notwithstanding that fact it is not common for a regulatory commission, where the property component of the rate base employed by it was less than the book value of such properties of the utility, to require the utility to write off or charge off the resulting difference.[13] Nor is it common, where the property component of the rate base employed is in excess of the value of such property of the utility as shown on its books, to require the utility to then record upon its books the resulting appreciation.

[13] The California Railroad Commission, in passing upon the rates of a transportation company, employed a rate base which was only a small part of the book cost of the property involved, but did not suggest or require that the difference should be charged off. Re *Market Street Railway Company*, 54 P. U. R. (N. S.) 214; *Market Street Railway Company* v. *Railroad Commission of the State of California*, et al., ... U. S. ...; 89 L. Ed. Adv. Op. 788.

The order of the Commission of February 3, 1943 (R. 36) requiring Petitioner to write off or charge off the amounts determined by the Commission not to represent a part of the original cost of the electric properties of Petitioner is unreasonable, arbitrary and confiscatory. The constitutional guarantee of due process demands that a regulatory law, order or regulation shall not be unreasonable, arbitrary or capricious and that the means selected shall have a real and substantial relation to the object sought to be obtained. An arbitrary or unreasonable regulation or order is a violation of due process and the Fifth Amendment to the Constitution of the United States. *Nebbia* v. *N. Y.*, 291 U. S. 502, 525; 78 L. Ed. 940, 950; *Chicago, R. I. & Pac. R. Co.* v. *U. S.*, 284 U. S. 80, 97; 76 L. Ed. 177, 186.

The restraint imposed upon legislatures by the due process clause of the Fifth and Fourteenth Amendments to the Constitution of the United States is the same.

> "The restraint imposed by legislation of the due process clauses of the two amendments is the same." *Hemer* v. *Dorman* (1932), 285 U. S. 312, 326; 76 L. Ed. 772, 779.

THE AMOUNTS PAID BY PETITIONER FOR ITS ELECTRIC PROPERTIES CANNOT BE DESTROYED BY THE ARBITRARY AND RETROACTIVE APPLICATION OF SO-CALLED RULES OF ACCOUNTING.

The electric properties of Petitioner acquired by it by purchase were acquired over a period of years extending from 1902 to 1929 (R. 915-920), long before the Commission was vested with any accounting jurisdiction, long before regulatory commissions had set up the gilded calf of original cost, and, in fact, many of the acquisitions were made long before the Commission had been established.

The properties were purchased from strangers in a series of arm's-length transactions long before the phrase

"original cost" had become a fetish with regulatory commissions, and with no knowledge on the part of Petitioner that at some time, many years later, it would be required to charge off a part of the cost of such properties to satisfy the arbitrary views of a regulatory agency not then in existence.

The property rights of Petitioner thus vested over this long period of time cannot be destroyed by the arbitrary and retroactive application by the Commission of so-called rules of accounting. This Court has recently had occasion to express its views on retroactivity in *Claridge Apartments Company* v. *Commissioner of Internal Revenue,* 323 U. S. 141, 164; 89 L. Ed. Adv. Op. 137, 149. "Retroactivity, even where permissible is not favored, except upon the clearest mandate. It is the normal and usual function of legislation to discriminate between closed transactions and future ones or others pending and not completed." See also *Lynch* v. *United States,* 292 U. S. 571; *W. B. Worthen Co.* v. *Kavanaugh,* 295 U. S. 56; *Louisville Joint Stock Land Bank* v. *Radford,* 295 U. S. 555; *Forbes Pioneer Boat Line* v. *Board of Commissioners,* 258 U. S. 338, and *Coombes* v. *Getz,* 285 U. S. 434. Petitioner should not be made to suffer because of "the Commission's preoccupation with bookkeeping and historical matter." *Colorado Interstate Gas Company* v. *Federal Power Commission,* et al., . . . U. S. . . . ; 89 L. Ed. Adv. Op. 807, 826.

THE APPLICATION OF SOUND ACCOUNTING PRINCIPLES DOES NOT REQUIRE PETITIONER TO CHARGE OFF TO ITS INCOME ACCOUNT THE AMOUNT OF $828,684.97 RECLASSIFIED BY IT IN ACCOUNT 100.5.

There is no recognized rule or principle of accounting requiring Petitioner to remove and charge off from its property accounts an amount of $828,684.97, simply because the amount paid by Petitioner for certain of its electric properties was $828,684.97 greater than the amount paid

by the original owners for such properties when they were first devoted to public service, and where the resulting difference has accordingly been reclassified by Petitioner in Account 100.5, Electric Plant Acquisition Adjustments, as required by the Uniform System of Accounts of the Commission.

Dr. William A. Paton, a recognized authority on accounting and the author or co-author of various works on accounting, testified on behalf of Petitioner that he knew of no principle of accounting requiring the charging off of the amounts reclassified in Account 100.5 (R. 137 et seq.). To the same effect was the testimony of Lewis Lilly, an accountant of long experience practicing his profession in the State of California (R. 230 et seq.).

The order of the Commission requiring the writing off of $828,684.97 is based on the opinion of members of its staff (R. 26-31). Presumably these members of the staff are Melwood W. Van Scoyoc, then Chief of the Division of Original Cost of the Commission, and Charles W. Smith, Chief of the Bureau of Accounts, Finance and Rates of the Commission, both of whom testified on behalf of the Commission at the hearing.

At all times subsequent to his graduation from college in 1927 to the time of the hearing in 1942, Mr. Van Scoyoc was an employee of the Public Service Commission of Oregon, the Public Utilities Commissioner of Oregon, and the Commission, with the exception of a period of slightly more than one year when he was not a regulatory commission employee (R. 790-793). Substantially all of Mr. Smith's experience was gained as an employee of various governmental and regulatory agencies, including the United States Treasury Department, the Public Service Commission of Maryland, and the Commission (R. 962-965). Messrs. Van Scoyoc and Smith, both members of the Com-

mission's staff, were the only witnesses who testified on its behalf that Petitioner should be obliged to charge off such amount of $828,684.97.

In the Arkansas Power and Light Company case and the Montana Power Company cases, infra, the soundness of the accounting treatment expressed by Dr. Paton was recognized by the Arkansas Department of Public Utilities and the Montana Public Service Commission, and the opinions of Mr. Smith[14] were discussed, found unsound and impracticable, and discredited.

> "Every administrative body has a specific job to do * * * its views on accounting accordingly are conditioned by its desires to reach the result, rather than by any interest in the healthy growth of accounting as a whole * * *."[15]

RECENT OPINIONS OF STATE REGULATORY COMMISSIONS SUPPORT PETITIONER'S CONTENTIONS IN THIS PROCEEDING.

In two original cost proceedings, subsequent to the opinion of the Commission in this case, and in both of which the Commission was an active participant, the Arkansas Department of Public Utilities[16] and the Montana Public Service Commission[17] held that the accounting views advocated by Petitioner, and sustained by its expert accounting witnesses, with respect to Petitioner not being

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14 In a recent series of three articles James L. Dohr, professor of accounting at Columbia University, has pointed out the unsoundness of the views expressed by Mr. Smith and by the Commission, and the fact that the charge-off principles so advocated by Mr. Smith and required by the Commission are directly contrary to sound and established accounting practice. The Journal of Accountancy, Vol. 79, No. 6, P. 432; Vol. 80, No. 1, P. 15; Vol. 80, No. 2, P. 111.

15 A. A. Berle, "Accounting and the Law," *Accounting Review*, Vol. xiii, No. 1, pp. 11 and 15 (March, 1938).

16 Re Arkansas Power and Light Company (Arkansas Department of Public Utilities, June 24, 1944, 55 P. U. R. (N. S.) 129—Affirmed on review by the Circuit Court of Pulaski County, Arkansas).

17 Re The Montana Power Company (Montana Public Service Commission, December 21, 1944, 56 P. U. R. (N. S.) 193).

compelled to charge off such amount of $828,684.97 were correct, and that the views of the Commission in attempting to compel a charge-off of amounts reclassified in Account 100.5, under the guise of a uniform system of accounts, were incorrect and unsound. Because of the language and reasoning employed by these two state commissions extensive quotations from their opinions have been used in this brief.

THE ARKANSAS POWER AND LIGHT COMPANY CASE.

The facts in the Arkansas Power and Light Company case with respect to the acquisition of electric properties by that company, and the subsequent accounting reclassification of the differences between the cost of such properties to the acquiring company and "original cost" thereof, are quite similar to the facts involved in the present proceeding.

The Arkansas Department of Public Utilities had established a uniform system of accounts substantially identical with that of the Commission, and had required Arkansas Power and Light Company to show cause why its books and accounts should not be adjusted to conform with such system of accounts. It appears that Arkansas Power and Light Company had purchased a number of small electric light plants and systems for the purpose of assembling them into an integrated electric system. As is inevitable in the purchase of any electric properties the price so paid for the Arkansas properties was not identical with the "original cost" thereof, with the result that under such uniform system of accounts approximately $7,000,000 was required to be reclassified in Account 100.5.

An extended original cost hearing was held before the Arkansas Department of Public Utilities. Prior to such

hearing an investigation of the accounting studies of Arkansas Power and Light Company had been made by the staff of the Commission, and the staff of the Commission had prepared a draft of a proposed joint report which the chief accountant of the Department refused to sign[18] because of a disagreement as to the amounts assignable to Accounts 100.5 and 107.[19]

The Arkansas Department, therefore, had before it the question of whether it could, under a uniform system of accounts substantially identical with that of the Commission, compel, or was it required to compel, an electric utility company to charge off the difference between the amounts paid by it for certain of the properties which it had acquired and the "original cost" of such properties. The Arkansas Department held that such difference, amounting to approximately $7,000,000, need not be charged off, and on the contrary was an element to be considered in fixing rates. The reasoning adopted by the Department is shown in the following excerpts from its opinion:

> "The record in this case shows that there is a very sharp conflict of opinion in the accounting field as to the correct original cost accounting principles which should be applied with respect to public utilities. In this case, the conflict centers around the question as to the accounting and disposition of the amount properly included in Account 100.5—Electric Plant Acquisition Adjustments.

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18 55 P. U. R. (N. S.) 138.

19 55 P. U. R. (N. S.) 141. The possibility and probability of conflict between the Commission and state regulatory commissions were pointed out by Petitioner in its briefs filed with the Court below, as well as the impossibility of compliance with state regulatory commission accounting requirements if the charge-offs sought by the Commission were effected. The opinions of the Arkansas Department of Public Utilities and the Montana Public Service Commission discussed herein are ample evidence of the prophetic nature of the contentions so made by Petitioner.

In support of its contention with respect to this highly controversial question, the respondent has offered in evidence the expert testimony of several witnesses who have gained national reputation and who are conceded to be among the leaders in the accounting field. The witnesses for respondent on this question were as follows:

Mr. George O. May of New York, who is author of 'Financial Accounting' and who was formerly the senior partner and chief executive of the firm of Price, Waterhouse and Company. At one time he was consulting accountant to the New York Stock Exchange.

Mr. Thomas Henry Sanders of Cambridge, Massachusetts, who is now professor of accounting at the Graduate School of Business Administration of Harvard University. He is the author of many books, articles, and reviews on accounting subjects, including 'A Statement of Accounting Principles,' in the preparation of which he collaborated with Mr. H. R. Hatfield and Mr. U. Moore.

Mr. William A. Paton of Ann Arbor, Michigan, who is now professor of accounting in the School of Business Administration and professor of economics at the University of Michigan. Mr. Paton is the author of many books including 'Advanced Accounting' which was published in 1941.[20]

Mr. Henry A. Horne of Brooklyn, New York, who is a member of the firm of Webster, Horne and Blanchard of New York and who is the author of many magazine articles and pamphlets on matters relating to the practices of accounting.

Mr. Walter B. Cole of Fayetteville, Arkansas, who is professor of accounting in the College of Business Administration at the University of Arkansas. In addi-

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[20] Mr. Paton was a witness for the Petitioner in the present proceeding (R. 130-158; 306-451) and testified that in his opinion proper accounting procedure did not require an arbitrary charging off of the amount of $828,684.97 reclassified by Petitioner pursuant to the Commission's Uniform System of Accounts in Account 100.5, Electric Plant Acquisition Adjustments.

tion to teaching, he has been engaged in the practice of accounting since 1926.

Mr. Joe Bond of Little Rock, Arkansas, who is a member of the firm of Joe Bond and Company and who has had considerable experience in the regulatory field. He has been actively engaged in the practice of accounting for many years. He is a member of the American Institute for Accountants and has served as secretary of the Arkansas State Society of Certified Public Accountants.

The opposing views were presented in this record by Mr. Charles W. Smith and Mr. Fred Kleinman who testified as witnesses for the Department. Mr. Charles W. Smith is the chief of the bureau of accounts, finance and rates of the Federal Power Commission. Mr. Fred Kleinman is chairman of the National Association of Railroad and Utilities Commissioners' Committee on Accounts and Statistics for Public Utilities. He is also chief accountant of the Illinois Commerce Commission.

The expert accounting authorities heard in this proceeding agree that the correct basis of accounting for recording fixed assets is cost. They are also in agreement that this cost should be the cost to the accounting company. This accounting principle being accepted, it seems that there should be little difference of opinion as to the proper method of accounting for the fixed assets of a public utility. Such is not the case, however. Charles W. Smith and Fred Kleinman, who are two of the nation's foremost proponents of the 'original cost' concept, take the view that any cost incurred by the accounting utility in the acquisition of utility property, which cost exceeds the original cost thereof, should be amortized."[21] (pp. 153-154).[22]

[21] It will be noted that the Arkansas Department characterizes Charles W. Smith, Chief of the Bureau of Accounts, Finance and Rates of the Commission, who testified on behalf of the Commission in the present proceeding, as one of the "nation's foremost proponents of the 'original cost' concept." Inasmuch as the conclusions of the Arkansas Department are flatly contrary to the views expressed by Mr. Smith, it would appear that the Department regarded his views as being founded upon the enthusiasm of theory rather than upon sound principles of accounting.

[22] All page references are to 55 P. U. R. (N. S.).

After referring to and considering the testimony of the various accounting witnesses, the Department states its conclusions as follows:

> "The Department has heard much testimony, in addition to the above quotations, regarding the original cost concept of accounting. It believes that this concept, as generally advocated for accounting in the regulatory field of public utility cost accounting, is based upon accounting principles or conventions evolved from entirely different economic concepts and from cost accounting in a field unregulated except as to competition. The Department finds that, in so far as strict accounting principles are concerned, there is ample authority for the amortization of the cost of intangibles. This accounting authority, however, does not presume to make the amortization of intangibles mandatory, even in unregulated industries. It recognizes the trusteeship of management as the custodian of the funds of the particular business. It leaves the matter of the disposition of amounts carried in the accounts representing the costs of intangibles entirely to the discretion of that management. Accounting authority recognizes that accounting is the recording, classifying, and summarizing of costs and in no way attempts to account for values, except in so far as liquid assets, as distinguished from fixed assets, are concerned. It also recognizes that whatever values exist in an unregulated industry remain in that industry, regardless of the method of accounting for the costs thereof.
>
> There are those who urge that these principles do not apply, however, in the regulated field of public utility accounting. They seek to evaluate the properties of public utilities on the basis of the original cost of the properties used in public service. The Department finds that this view is not in accord with sound accounting principles for the following reasons:

(1) Accounting for public utility plant is on the basis of cost rather than value.

(2) Cost of fixed assets, as interpreted by the accountant, is the cost to the accounting company, rather than cost to some prior owner.

(3) Accounting for utility property on the basis of the segregation of the original cost of those properties from the cost of acquisition thereof, as required by its Uniform System of Accounts for Electric Utilities, is not in violation of sound accounting principles.

(4) The segregation of these costs into separate subaccounts of a balance sheet account is an expedient to facilitate the supervision and rate regulation of public utilities.

(5) Accounting does not attempt to determine values of fixed assets.

(6) Costs representing determined values are properly includible in the accounts of a utility regardless of the intangibility of the asset acquired by such cost and regardless of the lapse of time between the occurrence of such costs and the evaluation of the asset acquired.

(7) The accounting for such costs is the accounting by management of its trusteeship of funds.

(8) The disposition of costs of so-called intangibles representing determined value is, primarily, a matter of judgment of management and regulatory agencies, rather than a mandatory provision of accounting.

From the standpoint of established accounting principles, therefore, it is apparent that an item should not be stricken from the record merely because it is classified by an accountant as an intangible asset.

While the administration of a system of accounts, by a regulatory body may involve other than accounting determination, it cannot direct a disposition of amounts upon the premise that it is suggested by

sound accounting when, in fact, it has no such basis. Nor should we require accounting which is not in accord with sound accounting principles and practices. The record contains the statement that regulatory accounting has more latitude. To whatever extent this may be true, it is not without positive limitations, and care must be taken not to exercise powers which do not fall within the accounting field. True, our regulatory authority encompasses other powers than accounting supervision; yet we cannot legislate away existing rights, destroy values, or adjudicate rights and interests between persons under the guise of compelling uniform or more informative recording and reporting." (Pages 157-158)

After considering and discussing the American Telephone and Telegraph Company case, supra, the Department said:

"the Department believes and finds that a proper construction of the provision with respect to disposition of amounts charged to Account 100.5 does not require the amount remaining in said account to be charged off or amortized, irrespective of whether it represents value." (Page 159)

Following this discussion of the accounting principles applicable to Account 100.5 the Arkansas Department arrives at its conclusions concerning the amount of $6,947,058.92 reclassified by Arkansas Power and Light Company in Account 100.5 and representing the difference between the "original cost" of the electric properties of that company and the amount actually paid for such properties, as follows:

"Those who would charge off or provide for amortization of the balance remaining in Account 100.5 insist that such should be done because it represents payment for so-called intangible values. While it is true that the item may represent an intangible, that

fact, of itself, does not demand that it be given the treatment suggested.

In the opinion of the Department the provisions of its Uniform System of Accounts were designed and intended to preserve rather than destroy evidence of cost incurred as the result of an arm's length transaction, and do not require or permit arbitrary adjustments of accounts of the respondent or any other public utility which have the effect of destroying existing valid property rights. It, therefore, concludes that under its system of accounts no amount charged to Account 100.5 should be eliminated, if such costs are supported by value.

* * * * *

It is obvious that it is impossible under any theory of accounting to purge all intangible value from the records of a utility. Clearly intangible value exists in a rate base in a utility property—whether or not its presence be recognized as such. In fact, in any operating utility there is complete inseparability of tangible and intangible values.

Common ownership of these separate properties was necessary before integration was possible. Since Electric could not have purchased these going businesses and properties at their original cost, the amount paid for the properties, in excess of that figure, must be treated as a part of the cost of the entire integrated system, including the cost of all acquired intangibles. The question for determination, therefore, is whether cost of the right to integrate those going concerns and properties and to acquire the gross businesses, the customers and other intangible values acquired and exercised under the circumstances here in evidence, is an asset of such value, or such an increment to value, as to justify this cost. If these rights and these intangibles are now actual assets of continuing value, and were of such value at the time the cost was incurred, the amount assigned to Account 100.5 on account thereof should not be charged off.

It should not be necessary to enter into an exhaustive explanation of the benefits of physically integrated electric property. The development of the utility industry has been influenced, and the art has been advanced, more by the recognition of the values and extended use arising from wise and economical integration than, perhaps, any other factor. The Congress, by Section 202(a) of the Federal Power Act, clearly recognized that integration of electric properties is definitely in the public interest." (Pages 160-161)

"The evidence is further conclusive that neither respondent, nor anyone else, could have successfully integrated and operated the properties and obtained these results except through common ownership thereof, and that such ownership could not have been acquired if respondent, in acquiring the properties, had been limited in the price paid to a mere return to the various owners of the original cost of the physical properties.

After consideration of all the facts and circumstances, the Department finds that the respondent actually expended the item of $6,947,058.92, heretofore found to be chargeable to Account 100.5, and that it represents value as of the date it was expended, and that such value existed and was inherent in respondent's electric system on December 31, 1943; and, therefore, the amount of said item should not be charged off or amortized, and should now be recognized and included as a part of the valid and present existing assets and values * * *" (Page 162)

In discussing original cost as a rate base element the Arkansas Department said:

"A. T. Hadley, as quoted by Webster's International Dictionary, 1937 Edition, under its definition of value, states: 'The commercial or competitive theory bases value upon what the buyer is willing and able to offer for an article. The socialistic theory bases value

on what the article has cost the seller in the way of toil or sacrifice.'

Our institution and economy were originated and developed under the commercial or competitive theory commonly referred to as private enterprise. The protagonists of the socialistic concept advance interesting arguments, some of which blindly ignore human nature elements—for their position. However, until the majority of our people have been convinced of the soundness of their views, and until the socialistic concept has been adopted into our government and economy, our actions and procedures should be based upon the commercial or competitive theory.

* * * * *

It is reasonably certain that they (the electric properties in question) could not have been acquired by the respondent nor anyone else, at their original cost because human experience teaches that men are loath to sell, unless a profit can be realized. Likewise, if it had been known at the time these properties were acquired that the purchaser would not be allowed to earn a return on the excess of original cost, but must treat such excess as a total loss, no prudent man would have made an investment under the circumstances.

* * * * *

The results following the fulfillment of the plan of integration have fully justified the expenditure. To now deprive the respondent of this investment, after the benefits of the plan have been realized and enjoyed by the public for more than twenty years, would deprive the respondent of its property without due process, as the state and National Constitutions were construed, understood, and applied when the investment was made." (Pages 165-166)

"Since this excess of investment over original cost was prudently made, has resulted in public benefits, and has not been recouped by the investors, and today represents existing and functioning values, the Department finds that it would be economically unsound and

morally wrong to exclude the arm's-length excess over original cost from the rate base. The Department therefore will not adopt original cost depreciated as a rate base." (Page 167)

In a concurring opinion Commissioner Morrison of the Arkansas Department used the following language:

"The original cost concept is at absolute variance with our American economy, which is based upon the individual receiving the fruits of his own labor and enterprise. If any argument were needed as to the effectiveness of our system, the comparison of our war production with that of other nations which have different economies, would settle all doubt.

Original cost undertakes to eliminate arm's-length profits. It is not only opposed to our economy, but it is fundamentally unsound. It either must be abandoned in the utility field as a formula, or it must be adopted in other fields of business, because it is as true in our economy as it is elsewhere that 'a house divided against itself cannot stand.'" (Page 187).

THE MONTANA POWER COMPANY CASE.

On December 21, 1944, the Montana Public Service Commission issued its opinion[23] with respect to the original cost of the properties of The Montana Power Company, following an extended hearing in which both the Commission and the Montana Commission participated. The Montana Power Company case involved the reclassification of approximately $7,000,000 in Account 100.5, Electric Plant Acquisition Adjustments. The opinion of the Montana Commission is in harmony with the opinion of the Arkansas Department of Public Utilities in the Arkansas Power and Light Company case, supra, and makes use of a substantial part of the language used in the opinion of that Department and which has been quoted in the preceding pages of this brief. One of the expert accounting witnesses who appeared on behalf of the Montana Power Company was

[23] 56 P. U. R. (N. S.) 209.

Mr. Wm. A. Paton who was also a witness for Petitioner in the present proceeding.[24]

The transactions involved in the Montana Power Company case included the acquisition of various electric properties, by purchase, consolidation or merger, in part from affiliates and in part from non-affiliates. The attention of this Court is directed to the following statements of accounting and regulatory principles from the opinion of the Montana Commission, all of which principles are in direct accord with the principles set forth in Petitioner's brief as to the amount of $828,684.97 reclassified by Petitioner in Account 100.5, Electric Plant Acquisition Adjustments, and the amount of $636,237.23 sought to be reclassified by the Commission in Account 107, Electric Plant Adjustments:

> "* * * the original cost system of accounts is a revolution in accounting." (P. 201)[25]
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> • • • • •
>
> "As heretofore set out, this system of accounts (original cost system) has many subdivisions, *the purpose of which is to disclose the breakdown of all of the items contained in the plant accounts of an electric utility.*" (P. 202) (Emphasis supplied)
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> • • • • •
>
> "This Commission believes that all value of any property, utility or otherwise, is based partly upon certain intangibles * * *. It is therefore impossible for this Commission to absolutely and exactly segregate intangibles from tangibles;[26] and with this in mind, this Commission shall interpret this system of accounts, and for that among other reasons, this system of accounts was adopted. This Commission will consider intangibles and will amortize them in Account 100.5 or will permit them to remain in the plant account, as it

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24 R. 130-158; 306-451.

25 All page references are to 50 P. U. R. (N. S.).

26 If a state regulatory commission cannot arrive at an exact segregation of intangibles from tangibles with respect to properties located in that state, by what magic can the Commission achieve such a segregation.

sees fit, in accordance with the surrounding circumstances in any particular case, depending upon what its best judgment shall dictate.

* * * * *

The value of property fluctuates. The original cost system fixes one point in that fluctuation. It determines the cost to the person who first devotes the property to a public use. It also retains the cost to the present accounting utility, which for many years has been the sole basis of the accounts of such a utility. This makes for an accounting revolution in utility accounting. A company has been keeping its books under a system of accounts which is based solely on cost to that company when suddenly we switch to a new revolutionary system. Care must be used therefore to attempt in all transactions subsequent to the original cost transaction to arrive at a fair result. *For that reason we believe we should supplant judgment for formulae.*[27] (Pp. 204, 205) (Emphasis supplied)

"We believe our system of accounts contemplates, and this opinion is based on the theory, that a transaction between affiliates should be recognized to the extent that it is based on the fair commercial value of the property at that time; that such a transaction should be closely scrutinized, but that if it meets all of the tests which can be applied for fairness and sound commercial value that it should then be recognized.

The Federal Power Commission staff, in reaching its conclusions, disregarded state laws; and their brief argues that the Federal Power Act supersedes state law. We do not believe that this Federal agency has the right to disregard state laws. * * * [28]

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[27] This same policy is stated by Mr. Justice Jackson in his dissenting opinion in the Hope Natural Gas case, 320 U. S. 591, 660; 88 L. Ed. 333, 375. "This problem (the Natural Gas Act) presents the Commission an unprecedented opportunity if it will boldly make economic, instead of legal and *accounting theories*, the foundation of Federal policy." (Emphasis supplied.)

[28] The jurisdictional conflict between the Commission and the state commissions is constantly becoming more pronounced. The Public Service Commission of New York has asserted that the Commission is endeavoring to exceed its powers under the Natural Gas Act with respect to the accounts and reports of natural gas companies operating in New York State. Federal Power Commission Release No. 2651, March 11, 1945.

* * * we cannot agree with a Federal agency which refuses to recognize a transaction carried out under state law." (p. 206)

* * * * *

"Most accounting authorities are agreed that a cost can be created by a transaction between affiliates. *This is recognized accounting.*" (p. 208) (Emphasis supplied)

"We feel that that decision (Arkansas Power and Light Company opinion, supra) is the outstanding decision on the original cost system of accounts, and the principles therein set forth are quite nearly adhered to by this Commission. We feel that it treats the system of accounts realistically and as it should be treated." (pp. 208, 209)

"Like the Arkansas Commission we believe that the three eminent and independent accounting authorities who testified on the subject of transactions between affiliates in this case have 'national reputations and are conceded' to have no superiors in the field of accounting and economics. According to them, the test of the validity of a transaction between affiliates is whether the sound commercial value of the property at the time of the transaction supports the price paid."[29] (p. 209)

"These accounting authorities were Dr. Thos. H. Sanders, Dr. Wm. A. Paton, and Mr. Henry A. Horne.

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[29] With respect to the amount of $636,237.23 which the Commission seeks to compel Petitioner to charge off as representing alleged inter-company engineering profits the Commission has consistently refused to allow Petitioner to introduce evidence with respect to the commercial value of the engineering services rendered to Petitioner by Byllesby Engineering and Management Corporation. The attitude of the Commission in refusing this opportunity to Petitioner was apparently paralleled in the Montana Power Company case, the Montana Public Service Commission having stated in a memorandum forwarded to all state utility regulatory commissions subsequent to the Montana Power Company hearing that:

"Montana Power Company, when it tried to introduce evidence thought admissible, was told by the examiner that it would not hear such evidence. Our state commission, however, did hear that evidence, as we thought it was admissible and important in properly hearing the case. The F. P. C.'s attitude at all times both at the hearings and in meetings was plain—and that was that they wanted to write off $54,000,000, no matter what the facts showed." Public Utilities Fortnightly, Vol. XXXV; No. 5, p. 303; March 1, 1945.

Each was an independent and impartial witness. (p. 209) (Emphasis supplied.)

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"It is argued that no cost can be created in a transaction between affiliates. However, we were greatly impressed with the learning, the honesty, and the straight-forward way in which these independent accountants gave their testimony. We believe that unless we adopted the principles to which they testified we would be going contrary to sound accounting principles."

"In the recent case of *Federal Power Commission* v. *Hope Nat. Gas Co.* (1944), 320 U. S. 591, 88 L. ed. 276, 51 P. U. R. (N. S.) 193, 64 S. Ct. 281, the Supreme Court had before it a case of a natural gas utility and the regulation of its rates. Mr. Justice Jackson, in a dissenting opinion, had the following to say in a footnote. We are, however, very much impressed by the language therein; and it is the theory we are following in our decision of this case:

> 'To make a fetish of mere accounting is to shield from examination the deeper causes, forces, movements, and conditions which should govern rates. Even as a recording of current transactions, bookkeeping is hardly an exact science. As a representation of the condition and trend of a business it uses symbols of certainty to express values that actually are in constant flux. It may be said that in commercial or investment banking or any business extending credit success depends on knowing what not to believe in accounting. Few concerns go into bankruptcy or reorganization whose books do not show them solvent and often even profitable. If one cannot rely on accountancy accurately to disclose past or current conditions of a business, the fallacy of using it as a sole guide to future price policy ought to be apparent. However, our quest for certitude is so ardent that we pay an irrational reverence

to a technique which uses symbols of certainty, even though experience again and again warns us that they are delusive. Few writers have ventured to challenge this American idolatry, but see Hamilton, Cost as a Standard for Price, 4 Law and Contemporary Problems 321, 323-325. He observes that "As the apostle would put it, accountancy is all things to all men. * * * Its purpose determines the character of a system of accounts." He analyzes the hypothetical character of accounting and says "It was no eternal mold for pecuniary verities handed down from on high. It was—like logic or algebra, or the device of analogy in the law—an ingenious contrivance of the human mind to serve a limited and practical purpose * * * Accountancy is far from being a pecuniary expression of all that is industrial reality. It is an instrument, highly selective in its application, in the service of the institution of money making." As to capital account he observes "In an enterprise in lusty competition with others of its kind, survival is the thing and the system of accounts has its focus in solvency. * * * Accordingly depreciation, obsolescence, and other factors which carry no immediate threat are matters of lesser concern and the capital account is likely to be regarded as a secondary phenomenon, * * * But in an enterprise, such as a public utility, where continued survival seems assured, solvency is likely to be taken for granted. * * * A persistent and ingenious attention is likely to be directed not so much to securing the upkeep of the physical property as to making it certain that capitalization fails in not one whit to give full recognition to every item that should go into the account." ' "

We agree with Justice Jackson that common sense should be used in interpreting and applying a system of accounts." (pp. 209, 210)

"The Federal Power Commission staff argues that the Butte Electric and Power Company purchased it

(certain lands and land rights) to eliminate competition[30] but there is no evidence in the record to that effect. The only evidence in the record is that it was purchased for its power site value." (pp. 215, 216)

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"The staff's position is * * * in defiance of the evidence and is purely arbitrary and speculative. It amounts to no more than an attempt to guess off substantial elements of cost. It indulges in an unfounded and unwarranted presumption that there was a payment for intangibles, which is in turn based upon the unfounded and unwarranted presumption that the excess represented an intangible. Certainly, the compounding of unwarranted presumptions is entirely indefensible. The law requires a presumption to be based on fact, not another presumption."[31] (p. 216)

* * * * *

"A valuation necessary to determine cost must not be arbitrary or unreasonable. * * *

"Once the public is allowed to invest in a public utility a great deal of caution should be exercised before the valuation placed upon the property of the company is reduced." (p. 217)

* * * * *

"It is argued that the subsidiary was only an incorporated department of the parent, that there was a transaction between affiliates and that such a transaction cannot establish a cost. * * *

* * * we have not overlooked but specifically point out the complete affiliation between the parent, Great

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30 The Commission has also used the "elimination of competition" argument in its opinion in this proceeding (R. 26-31) in an attempt to lend color to the theory that Account 100.5 invariably represents intangibles of an ephemeral nature and not a part of the assets of the acquiring company.

31 The fallacy of the Commission's blind adherence to its accounting theories is also illustrated in the present proceeding by the reasoning in its opinion (R. 26-31) that Petitioner, because of its purchase of electric properties 30 years ago, is now to be penalized under original cost accounting theories because it did not at that time foresee attempted original cost accounting, and hence did not predicate the prices paid for properties at that time upon future accounting vagaries.

Falls Water Power & Townsite Company and its wholly owned subsidiary, Great Falls Power Company. * * *

* * * Nowhere in our system of accounts[32] is there any provision saying that cost cannot be created in a transaction between affiliates. We have given a thorough study to other provisions in our system and to established accounting principles as applicable to this case and find the need for recognizing a transaction between affiliates when based and only to the extent that it is based upon commercial value of the property, to be consistent. Under any other theory than the one adopted herein we find ourselves running amuck of constant contradictions. We have already referred to Electric Plant Instruction 3D to that effect. Moreover, the provisions of Plant Account Instructions 1C and 1D and the definition given in Account 100.5 all recognize the acquisition of property by merger or consolidation which inevitably leads us to the conclusion that *transactions between affiliates cannot be eliminated by any rule of thumb.*" (pps. 221, 222) (Emphasis supplied)

"We believe that a cost can be created in a transaction between affiliates if that transaction is based on sound commercial value." (pps. 222, 223)

* * * * *

"Some of the accounting witnesses have testified that in general intangibles do not tend to disappear and tend to continue and exist and should be retained in Account 100.5 as long as they do exist and continue to have value. *We recognize that intangibles do have value and should not be given the summary treatment of automatic amortization.*"[33] (p. 229) (Emphasis supplied)

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32 The system of accounts adopted by the Montana Public Service Commission is very similar to the system of accounts adopted by the Commission. 56 P. U. R. (N. S.) 197.

33 By its opinion No. 120 dated February 13, 1945 in "In the Matter of The Montana Power Company—Docket IT-5825" (57 P. U. R. (N. S.) 193) the Commission arrives at original cost and accounting conclusions greatly at variance with those of the Montana Public Service Commission, makes no mention of the opinion of that commission, supra, and disregards all of the accounting testimony introduced at the joint hearing excepting that of the members of its own staff.

THE APPLICATION OF SOUND ACCOUNTING PRINCIPLES DOES NOT REQUIRE PETITIONER TO RECLASSIFY OR TO CHARGE AGAINST ITS EARNED SURPLUS OR CAPITAL SURPLUS THE AMOUNT OF $636,237.23 WHICH THE COMMISSION SEEKS TO ESTABLISH IN ACCOUNT 107.

There is no recognized rule or principle of accounting requiring Petitioner to reclassify or to segregate in its accounts, or to charge against its earned surplus or capital surplus, the amount of $636,237.23 as the Commission seeks to require, simply because engineering services were rendered to Petitioner by an affiliated company.

The testimony of Dr. Paton and Mr. Lilly referred to, and the opinions of the Arkansas and Montana Commissions are ample support for the contention of Petitioner that the amounts paid to the Engineering Company for engineering services rendered during the period from 1926 to 1935 should remain in the property accounts of Petitioner as a part of its assets.

THE OPINION TESTIMONY OF MEMBERS OF THE COMMISSION'S STAFF AS TO THE AMOUNT OF $828,684.97 RECLASSIFIED IN ACCOUNT 100.5 NOT CONSTITUTING A PART OF PETITIONER'S PROPERTY, AND AS TO THE REQUIREMENT THAT PETITIONER BE OBLIGED TO RECLASSIFY $636,237.23 OF ITS PROPERTY ACCOUNTS IN ACCOUNT 107, AND TO CHARGE OFF SUCH AMOUNT TO EARNED SURPLUS OR CAPITAL SURPLUS, IS NOT SUPPORTED BY THE RECORD OR BY ANY ACCOUNTING OR LEGAL PRINCIPLES APPLICABLE TO THE ISSUES IN THIS PROCEEDING.

The principal witness on behalf of the Commission was Charles W. Smith, Chief of its Bureau of Accounts, Finance and Rates, susbtantially all of whose accounting experi-

ence was gained as a member of the staffs of various State and Federal commissions and departments (R. 963). Commission Witness Smith testified that the Uniform System of Accounts was the outgrowth of action on the part of the National Association of Railroad and Utilities Commissioners (R. 976); that he had participated in the work of that Association or its committee, or otherwise, in the drafting of a uniform system of accounts (R. 974), and that the first meeting of the Association's committee was held in the offices of the Public Service Commission of Maryland at a time when he was a member of the staff of that Commission (R. 974). Commission Witness Smith was of the opinion (R. 962-972) that the recommendations made in the staff report (Ex. 5, R. 908) with respect to the disposition of $828,684.97 reclassified by Petitioner in Account 100.5, and the amount of $636,237.23 sought to be reclassified by the Commission in Account 107, were proper, were in accord with sound accounting principles, and were either authorized or required by the Act or by the Uniform System of Accounts of the Commission.

On cross-examination, however, Commission Witness Smith (R. 972-1043) experienced great difficulty in pointing out any instances in which it appeared (a) from the deliberations of the National Association of Railroad and Utilities Commissioners, or its Committee on Statistics and Accounts; or in (b) the uniform system of accounts as drafted by the National Association of Railroad and Utilities Commissioners or such Committee; or in (c) the provisions of the Act, or in (d) the provisions of the Uniform System of Accounts adopted by the Commission, that amounts reclassified by utilities in Account 100.5 were required to be charged off, or that profits upon services rendered by an affiliated company were required to be reclassified in Account 107 and then charged off.

When questioned concerning the authority by which Petitioner might be compelled to make the charge-offs in question, Commission Witness Smith took refuge in generalities and in references to industrial accounting, and his views are without support.

IV.

THE COMMISSION IS WITHOUT JURISDICTION TO REGULATE ANY OF THE MATTERS SUBJECT TO REGULATION BY A STATE UTILITY COMMISSION.

As discussed elsewhere in this brief (pp. 78-80), Petitioner, as well as its accounting in so far as its electric properties are concerned, is subject to the public utility laws of the States of California and Oregon, the jurisdiction of the California Commission and the Oregon Commission thereunder, and the provisions of the uniform systems of accounts prescribed by the California Commission and the Oregon Commission. Notwithstanding such complete regulation by the States of California and Oregon, the Commission seeks, by the provisions of its order of February 3, 1943 (R. 36) to regulate matters subject to regulation by state utility commissions. Any such claimed jurisdiction has been specifically negatived by Congress by the language employed in Section 201(a) of the Act, (16 U. S. C. A. 824(a)), which reads as follows:

> "It is hereby declared that the business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest, and that Federal regulation of matters relating to generation to the extent provided in this Part and the Part III next following and of that part of such business which consist of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest, *such Federal regulation,*

however, to extend only to those matters which are not subject to regulation by the States.'' (Emphasis supplied.)

JURISDICTION OF STATE COMMISSIONS RECOGNIZED BY COMMISSION HERETOFORE.

The first system of accounts was prescribed by the Commission for licensees under the Federal Water Power Act by its order No. 13, dated November 20, 1922. This initial accounting system recognized the fact that such licensees might be subject to regulation by state utility commissions, in that Section 4(d) of the General Rules and Regulations, Information and Definitions accompanying the 1922 System of Accounts (page 3) read in part as follows:

(e) *Nothing contained in this system of accounts is to be construed as authorizing or permitting the licensee in any State having a regulatory body to depart from the system or classification of accounts prescribed by said State authority as to nonproject property nor is it to be construed as modifying or changing for State purposes the accounting or reporting requirements of such State regulatory bodies as to both project and nonproject property.* (Emphasis supplied.)

Thus it will be seen that as early as 1922 the Commission recognized, in its first system of accounts prescribed for licensees, the fact that such licensees might also be public utilities subject to the jurisdiction of state regulatory commissions, and as such required to keep their accounts and records in accordance with state regulatory requirements. The initial system of accounts so prescribed by the Commission remained in effect until January 1, 1937 when superseded by the present Uniform System of Accounts (Ex. 1).

The present system of accounts was adopted under the provisions of Section 301(a) of the Act, which section is a part of the 1935 amendments to the Federal Water Power Act, after Congress had declared in such amendments (Section 201(a) of the Act, 16 U. S. C. A. 824(a)) that Federal regulation should however "extend only to those matters which are not subject to regulation by the States."

It is obvious from the employment of this language that the intent of Congress, in the adoption of the 1935 amendments to the Act, was to regulate the conduct of the business of those public utilities subject to the jurisdiction of the Commission only *in so far as such public utilities were not subject to regulation by the states in which they operated.* This section of the Act, standing alone, is ample evidence of the Congressional purpose and intent that the States should not be deprived of their right to regulate public utilities.

This intent is also evidenced by other provisions of the 1935 amendments. Section 204 of the Act (16 U. S. C. A. 824(c)) makes detailed provision for the issuance of securities by public utilities subject to the jurisdiction of the Federal Power Commission, with a specific exemption for security issues regulated by a State commission

> "(f) The provisions of this section shall not extend to a public utility organized and operating in a State under the laws of which its security issues are regulated by a State commission."

For further cumulative evidence of the intent that the powers of the States should be reserved to them, it should be noted that Section 209 of the Act (16 U. S. C. A. 824(h)) provides for the use of a joint Federal and State board and cooperation with State commissions, and the provision in Section 301(a) of the Act (16 U. S. C. A. 825(a))

"* * * Provided, however, that nothing in this chapter shall relieve the public utility from keeping any accounts, memoranda, or records which such public utility may be required to keep by or under authority of the laws of any State. * * *"

and the provisions of Section 302(a) (16 U. S. C. A. 825a) with respect to the depreciation practices of public utilities

"* * * Nothing in this section shall limit the power of a State commission to determine in the exercise of its jurisdiction, with respect to any public utility, the percentage rate of depreciation to be allowed, as to any class of property of such public utility, or the composite depreciation rate, for the purpose of determining rates or charges.

(b) The Commission, before prescribing any rules or requirements as to accounts, records, or memoranda, or as to depreciation rates, shall notify each State commission having jurisdiction with respect to any public utility involved, and shall give reasonable opportunity to each such commission to present its views and shall receive and consider such views and recommendations."

The restrictions so imposed by Section 201(a) of the Act were specifically and purposely made in the 1935 amendments to the Act so that it might show unmistakably that the purpose of the amendment was that of supplementing and complementing state regulation and not for the purpose of superseding state regulation, and are confirmation of the fact that there is no statutory authority for the Commission

(a) to compel Petitioner, as a public utility operating in the States of California and Oregon, to charge a part of its plant investment against its income or surplus accounts,

(b) to require Petitioner to maintain a set of property records at variance with the accounting

systems prescribed by the California and Oregon Commissions, or

(c) to require Petitioner to effect what amounts to an improper statement of its property accounts or the maintaining of separate accounting records for purposes of state and federal regulation.

Legislative History of the 1935 Amendments to the Federal Water Power Act.

If there could be any doubt concerning the plain meaning of the restrictive language so employed in Section 201(a) of the Act, and quoted above, such doubt is convincingly dispelled by the review of the history of this legislation in *Connecticut Light & Power Company* v. *Federal Power Commission*, supra, which review brings forcefully to light

(a) the repeated assertions of members of the Commission, and its then legal adviser, that the language employed in the amendments, and particularly the language adopted in Section 201(a) above, was specifically designed to preserve and assure to the State Commissions their full and continuing measure of regulatory jurisdiction; and

(b) that if there could be any doubt concerning the interpretation of the language considered prior to the adoption of the legislation, or contained in the amendments as adopted, any such doubt has been resolved against the Commission by its own interpretation, given in connection with the legislative hearings, specifically delimiting its jurisdiction under the amendments.

At the time the amendments to the Federal Water Power Act were before Congress deep concern was expressed by the State Commissions, through the National Association of Railroad and Public Utilities Commissioners, that all future regulation of electric utilities would be centralized in

the Commission, with a consequent impairment and decay of state regulatory power.[34] That the fears of the State Commissions in 1935 were well founded became obvious as soon as the Commission began the exercise of its powers under the 1935 amendments, with the result that the State Commissions now seek, in the courts, to curb the continuing encroachment of the Commission upon state regulatory jurisdiction.

Obviously the Commission has repudiated its assertions to Congress when there are conflicts "which lead state officials to stand shoulder to shoulder with private corporations making common cause of resistance to Federal authority * * *." *Connecticut Light & Power Company* v. *Federal Power Commission*, supra.

COURTS WILL CONSIDER HISTORY OF LEGISLATION.

The language of Section 201(a) of the Act, 16 U. S. C. A. 824(a), is clear in its restrictive delineation of the powers of the Commission. If it is to be argued that there is any

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[34] Hearings on H. R. 5423, House Committee on Interstate and Foreign Commerce, 74th Cong. 1st Sess., where H. Lester Hooker, a member of the State Corporation Commission of Virginia, and then Chairman of the Legislative Committee of the National Association of Railroad and Utilities Commissioners, said:

"Our association has violent objections to many of the sections of this bill, as drawn. We feel that some of the sections included should be eliminated entirely. Under the guise of interstate commerce, the Congress is asked by this proposed legislation to take away the rights and privileges reserved to the States to a greater extent, we believe, than has any Congress thus far been asked to go on any similar subject.

"Titles II and III of title II, as now drawn, require the closest study and analysis of all of their provisions in order to comprehend their full purport, meaning, and probable ultimate result. When they are understood, and when you appreciate the true picture, which would result in the emasculation of the powers reserved to the States, you will not be surprised at my remarks about these sections of this proposed legislation. Power and privileges that always have, and always should be reserved to the States are here proposed to be lifted bodily from State regulation to absentee and long distance regulation from Washington, affecting matters which are essentially local. You no doubt have been amazed at the extent to which this legislation grasps at the very life of State supervision and control, notwithstanding that the proponents are claiming that they are seeking merely to aid State regulation. * * *" 1612.

doubt concerning these restrictive provisions and their scope, this Court has repeatedly held that enlightenment may be sought from the legislative history of the Act, including reports of congressional committees, etc. *Connecticut Light & Power Company* v. *Federal Power Commission*, supra, *Wright* v. *Mountain Trust Bank*, 300 U. S. 440, 464; 81 L. Ed. 736, 744; *U. S.* v. *Madigan*, 300 U. S. 500, 504; 81 L. Ed. 767; *Holy Trinity Church* v. *U. S.*, 143 U. S. 457, 463; 36 L. Ed. 226.

To determine the scope of an act, the court will consider the statements of the chairman of the congressional committee. *Binns* v. *U. S.*, 194 U. S. 486, 495; 48 L. Ed. 1087; *Duplex Co.* v. *Deering*, 254 U. S. 443, 474; 65 L. Ed. 349; *U. S.* v. *Coca Cola Co.*, 241 U. S. 265, 276; 60 L. Ed. 995; *Federal Trade Commission v. Raladam*, 283 U. S. 643, 648; 75 L. Ed. 1324; *Humphrey's Executor*, 295 U. S. 602; 79 L. Ed. 1611.

The court may consider the steps through which the act passed before and up to the time of its enactment. *Connecticut Light & Power Company* v. *Federal Power Commission*, supra; *U. S.* v. *Burr*, 159 U. S. 78, 85; 40 L. Ed. 82; *U. S.* v. *St. Paul M. & M. Railroad Co.*, 247 U. S. 310, 315; 62 L. Ed. 1130.

The court may refer to the history and events of the time of enactment of an act of Congress where that will aid the court in construing the act. *U. S.* v. *Union Pacific Railroad*, 91 U. S. 72, 79; 23 L. Ed. 224.

Continuing Jurisdiction of State Regulatory Commissions Upheld.

In 1938, and less than three years after the adoption of the amendments to the Federal Water Power Act discussed under this section of the brief, the Pennsylvania courts

had occasion to consider the declaration of policy, the intent of such amendments to the Federal Water Power Act and the continuing jurisdiction of the Pennsylvania commission. Such consideration arose in an action brought by two Pennsylvania utilities against the Pennsylvania Public Utility Commission to review certain orders of that commission denying such two utilities the right to merge and consolidate their assets. The two Pennsylvania utilities argued that because of the provisions of the 1935 amendments to the Federal Water Power Act sole jurisdiction with respect to such merger and consolidation was vested in the Commission and that for that reason the Pennsylvania Public Utility Commission was without jurisdiction. This contention was dismissed by the Superior Court of Pennsylvania in *Northern Pennsylvania Power Company et al.* v. *Pennsylvania Public Utility Commission,* 200 Atl. 866, 871 (1938) where the Court said (page 872):

> "* * * *it is clearly the purpose of the entire act to regulate only those matters which pertain to the interstate exchange of wholesale power.*"

The Supreme Court of Pennsylvania sustained the views so expressed by the Superior Court in *Northern Pennsylvania Power Company et al.* v. *Pennsylvania Public Utility Commission,* 333 Pa. 265; 5 Atl. (2) 133.

This Court has repeatedly held that the powers of the states to regulate the industries and businesses within their borders was complete until such time as Congress might circumscribe by specific federal legislation. *Connecticut Light & Power Company* v. *Federal Power Commission,* supra; *South Carolina State Highway Department et al.* v. *Barnwell Bros. et al.,* 303 U. S. 177; 82 L. Ed. 734; *Townsend et al* v. *Yeomans et al.,* 301 U. S. 441; 81 L. Ed. 1210; *H. P. Welch Company* v. *State of New Hampshire,* 306 U. S. 79; 83 L. Ed. 500; *E. Pat Kelly et al.* v. *State of Wash-*

ington on the relation of Foss Co. Inc., 302 U. S. 1; 82 L. Ed. 3.

In *Illinois Central Railroad Company* v. *Public Utilities Commission of Illinois*, 245 U. S. 493; 62 L. Ed. 425, this Court had occasion to pass upon an order of the Interstate Commerce Commission requiring a readjustment of certain intrastate rates fixed by the Public Utilities Commission of Illinois. The rule is aptly expressed in this opinion by Mr. Justice Van Devanter (Page 510):

> "In construing Federal statutes enacted under the power conferred by the commerce clause of the Constitution the rule is that it should never be held that Congress intends to supersede or suspend the exercise of the reserved powers of a state, even where that may be done, unless, and except so far as, its purpose to do so is clearly manifested. *Reid* v. *Colorado*, 187 U. S. 137, 148, 47 L. Ed. 108, 114, 23 Sup. Ct. Rep. 92, 12 Am. Crim. Rep. 506; *Cummings* v. *Chicago*, 188 U. S. 410, 430, 47 L. Ed. 525, 531; 23 Sup. Ct. Rep. 472; *Savage* v. *Jones*, 225 U. S. 501, 56 L. Ed. 1182, 32 Sup. Ct. Rep. 715; *Missouri, K. & T. R. Co.* v. *Harris*, 234 U. S. 412, 419, 58 L. Ed. 1377, 1382, L. R. A. 1915E, 942, 34 Sup. Ct. Rep. 790."

To the same effect are *Illinois Central Railroad Company* v. *McKindress*, 203 U. S. 514; 51 L. Ed. 298; *Missouri Pacific Railway Company* v. *Larabee Flour Mills Company, etc.*, 211 U. S. 612; 53 L. Ed. 352, and *Smith, et al.* v. *Ill. Bell Telephone Company*, 282 U. S. 133; 75 L. Ed. 255.

PETITIONER IS A PUBLIC UTILITY OPERATING IN THE STATES OF CALIFORNIA AND OREGON AND AS SUCH IS SUBJECT TO THE JURISDICTION OF THE CALIFORNIA COMMISSION AND OREGON COMMISSION.

Petitioner is a public utility operating in the States of California and Oregon and therefore subject to the juris-

diction of the California Commission under Title 464 of the General Laws of California of 1931, and to the jurisdiction of the Oregon Commission under Title LXI, Chapter II, Code of 1930, as amended by Chapter 103 of the Oregon Laws of 1941.

The California Commission and the Oregon Commission have each adopted and prescribed a uniform system of accounts, in form substantially identical with the Uniform System of Accounts prescribed by the Commission, for all electric utilities operating in those states. The charging off by Petitioner of any amount in Account 100.5, or the reclassification by Petitioner or by the Commission of any amount in Account 107, and the charging off thereof, as required by the Commission would make it impossible for Petitioner to comply with the accounting requirements of the California Commission or the Oregon Commission.

Petitioner could not, therefore, without violating the regulations of the California Commission and the Oregon Commission, and the uniform systems of accounts prescribed for electric utilities by those commissions, state its property accounts on its books at less than the cost thereof and unless Petitioner should proceed in complete disregard of the accounting rules of these two state commissions it could not reduce its electric plant accounts by making the charges against the income or surplus accounts required by the order of the Commission dated February 3, 1943 (R. 36). Any such failure on the part of Petitioner to comply with the accounting rules of these two state commissions would render Petitioner liable to punishment in accordance with the provisions of the public utility laws of those states above referred to.

Section 301(a) of the Act (16 U. S. C. A. 825(a)) requires public utilities to make and keep such records and accounts,

etc. as the Commission may by rules and regulations prescribe as necessary and appropriate for purposes of administration of the Act.

> "Provided, however, That nothing in this Chapter shall relieve any public utility from keeping any accounts, memoranda, or records which such public utility may be required to keep by or under authority of the laws of any State."

For the reasons stated above, compliance with the charge-off provisions of the Commission's order of February 3, 1943 (R. 36,) would relieve Petitioner from keeping the accounts and records required to be kept by it as a public utility operating in the States of California and Oregon, in that it would not then be able to show on its accounts and records the cost of its property as required under the rules and regulations of the California Commission and the Oregon Commission. It is obvious, therefore, that such order is contrary to the expressed provisions of the Act.

It is equally obvious that Section 201(a) of the Act (16 U. S. C. A. 824(a)) clearly and definitely limits the jurisdiction of the Commission by providing

> "* * * such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States."

and that inasmuch as the accounting and the records and books of account of Petitioner are subject to regulation by the California Commission and the Oregon Commission, in accordance with the laws of those States, the Commission has no jurisdiction with respect thereto.

V.

THE ORDER OF THE COMMISSION REQUIRING PETITIONER TO WRITE OFF OR CHARGE OFF TO ITS INCOME OR SURPLUS ACCOUNTS THE AMOUNT OF $828,684.97 RECLASSIFIED BY PETITIONER IN ACCOUNT 100.5, AND THE AMOUNT OF $636,237.23 WHICH THE COMMISSION SEEKS TO ESTABLISH IN ACCOUNT 107, IS AN INVASION OF MANAGERIAL FUNCTIONS AND AS SUCH IS NOT WITHIN ANY REGULATORY POWERS OF THE COMMISSION.

It has long been a well-established rule of law that regulatory commissions, charged with the supervision and regulation of public utilities, might not substitute their judgment for the judgment of the directors or managing officers of the utility. Regulatory commissions have recognized this principle to the extent that the courts are not often called upon to repeat the rule, which has, however, been well-expressed by the Court of Appeals of New York in *People ex rel. Iroquois Gas Corporation* v. *Public Service Commission of the State of New York, supra,* 264 N. Y. 17; 189 N. E. 764 (1934). In this case the public utility, Iroquois Gas Corporation, sought the consent of the Public Service Commission of the State of New York to the acquisition of certain natural gas properties. That Commission, in authorizing the purchase, and in the belief that the purchase price was too high, required the purchaser to charge the amount of $40,000 against its surplus.

The Court of Appeals, in discussing the powers of the New York Commission, said (189 N. E. 765):

> "It (the New York Commission) *cannot make its consent dependent upon conditions* which are unreasonable or which do not change the terms of the transfer of the franchise, works, or systems, *or which encroach upon the right of the relator to administer its corporate affairs according to its judgment in matters*

in which the legislature has not given the Public Service Commission any regulatory or supervisory powers.

* * *

The power vested in the Commission to prescribe, uniform methods of keeping accounts and records, does not include the power to compel a corporation to write off from its book value a loss which does not sustain, or to give up a part of its constitutional rights. If, as has been said, the actual cost of the property—the investment the owners have made—is a relevant fact (Los Angeles Gas and Electric Corporation v. *Railroad Commission of California,* 289 U. S. 287, 306; 43 Supreme Court 637, 644; 77 L. Ed. 1180), *a corporation cannot be compelled to make entries upon its books calculated to conceal such relevant fact. It follows that the Commission had no power to impose such condition."* (Emphasis supplied.)

This Court has recognized this same principle as being applicable to Federal regulatory bodies, having said in *Interstate Commerce Commission* v. *The Chicago G. W. R. Company* (1908), 209 U. S. 108, 118, 52 L. Ed. 705, 712:

> "It must be remembered that railroads are the private property of their owners; that while, from the public character of the work in which they are engaged, the public has the power to prescribe rules for securing faithful and efficient service and equality between shippers and communities, yet, in no proper sense, is the public a general manager."

In *Atchison, Topeka and Santa Fe R. R. Co.* v. *United States et al.* (1932), 284 U. S. 248, 262, 76 L. Ed. 273, 52 Sup. Ct. 146, 150 Chief Justice Hughes, referring to the functions and powers of the Interstate Commerce Commission to enforce public rights, said:

> "But the Commission, exercising a delegated regulatory authority which does not have the freedom of

ownership, operates in a field limited by constitutional rights and legislative requirements."

In passing on the powers of the New York Commission the Supreme Court of New York in *New York Edison Company et al.* v. *Maltbie et al., supra,* 244 App. Div. 685; 281 New York Supp. 223; 9 P. U. R. (N. S.) 155, and after reciting the Iroquois Gas Corporation case, supra, (264 N. Y. 17; 189 N. E. 764) said (281 New York Supp. 226):

> *"The legislature granted to the Commission power to prescribe uniform methods of keeping accounts, records, and books* (Subd. 41 § 66, P. S. L.). *The statute does not authorize the Commission to prescribe uniform methods of management of the business of privately owned corporations. The uniformity that may be enforced is not as to what shall be done or how it shall be done, but as to book entries in respect to whatever is done. Kansas City S. R. Co.* v. *United States, supra."*

The Maltbie case was affirmed by the Court of Appeals of New York in *New York Edison Co., et al.* v. *Maltbie, et al., supra,* 271 N. Y. 103; 2 N. E. 2d 277 (1936), where the court said:

> "We agree with the Appellate Division in its construction of the orders of the Public Service Commission. *On that construction, the orders were more than general administrative or legislative rules. They directly interfere with private property rights of these respondents."* (Emphasis supplied.)

The American Telephone and Telegraph Company case (*American Telephone and Telegraph Company et al.* v. *United States of America, et al., supra,* 299 U. S. 232; 81 L. Ed. 142 (1936), while it relates primarily to the original cost provisions of the Uniform System of Accounts prescribed by the Federal Communications Commission, and is therefore distinguishable from the Iroquois Gas Corpora-

tion case, supra, 264 N. Y. 17; 189 N. E. 764, also reiterates the rule that regulatory commissions may not interfere with the internal affairs of utilities.

CONCLUSION.

Wherefore Petitioner submits that its petition herein should be granted in order that there may be a determination by this court of the questions of law involved in this case, and that the decision of the court below should be set aside.

Respectfully submitted,

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